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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972.

No. 72-283

GEORGE E. MAHIN, AS DIRECTOR OF REVENUE OF THE STATE OF ILLINOIS,

Petitioner,

vs.

TERRANCE R. MITCHELL, ASALEE LABORN, ERNEST J. NASSOS, JOHN A. PETERSON AND FREDERICK W. WENDNAGEL,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ILLINOIS.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

George E. Mahin, as Director of Revenue of the State of Illinois (petitioner), respectfully prays that a writ of certiorari issue to review the decision of the Illinois Supreme Court rendered on April 17, 1972. A timely motion for rehearing was denied on May 25, 1972.

OPINIONS BELOW.

The order of the Circuit Court of Cook County, Illinois, Law Division, was entered on January 19, 1971, and the opinion of that Court was filed on February 4, 1971. The order and opinion are not reported, but are printed in their entirety in the Appendix hereto. The opinion of the Illinois Supreme Court is reported in 51 Ill. 2d 452, 283 N. E. 2d 465, and is also printed in the Appendix hereto.

JURISDICTIONAL GROUNDS.

The opinion of the Illinois Supreme Court was filed April 17, 1972. A timely petition for rehearing was filed by petitioner and an order denying said petition was entered on May 25, 1972. Said order is printed in the Appendix hereto. The jurisdiction of this Court is invoked under 28 U. S. C. § 1257(3).

STATEMENT OF FACTS AND QUESTIONS PRESENTED FOR REVIEW.

In order for the Court fully to understand the questions presented by this case, it is necessary for it to be apprised of certain essential facts.

The Illinois Income Tax Act was enacted by Act approved July 1, 1969, effective August 1, 1969. Its constitutionality was immediately challenged by an original taxpayers' action filed in the Illinois Supreme Court by leave of that Court. The cause was submitted on petition, supplement to petition and the answer of the defendant State officials. Briefs were filed by the parties and certain amici curiae. **No question of fact was presented to the Court.** The Court's opinion appears in *Thorpe* v. *Mahin*, 43 Ill. 2d 36, 250 N. E. 2d 633, and is printed in the Appendix hereto.

The *Thorpe* case presented grave constitutional questions, both State and federal, to the Court. A previous decision, *Bachrach* v. *Nelson*, 349 Ill. 579, 182 N. E. 909 (1932), had held an earlier Illinois income tax unconstitutional under the State Constitution, and the Constitution had not been amended since that decision. In addition, petitioners contended that "if the Act is to be applied to the realization of increased value of capital assets accruing prior to August 1, 1969, they would thereby be deprived of property without due process of law and be denied equal protection of the law." (*Thorpe* v. *Mahin*, 43 Ill. 2d 36 at 50, 250 N. E. 2d 633 at 640 (1969).) Thus, the Illinois Supreme Court was confronted with serious challenges to the new Income Tax Act based upon pro-

visions of both the Illinois and United States Constitutions. At the same time, as the Court recognized:

> * * * It is common knowledge that the Illinois Income Tax Act was enacted to fulfill a desperate need for funds to insure the financial stability of the State and the continuance of its essential governmental functions, * * *. [*Sherman-Reynolds, Inc.* v. *Mahin*, 47 Ill. 2d 323 at 327, 265 N. E. 2d 640 at 642 (1970)]

By order entered on July 25, 1969, the Court sustained the new tax against the constitutional challenges made by petitioners. However, the order stated that, in its conclusion that the Income Tax Act was constitutional, the Court considered "the legislative intent to be that, in the computation of capital gains and losses, the value of property acquired prior to August 1, 1969, shall, for the purpose of computation of capital gains or losses be determined as of August 1, 1969." A copy of this order is printed in the Appendix hereto.

The Court's order of July 25, 1969 was the first mention in the *Thorpe* proceedings of legislative intent regarding an August 1, 1969 valuation limitation. No argument had been presented and no evidence had been introduced to support this conclusion. To the contrary, all of the parties had assumed the absence of an effective date valuation limitation in the Act, and had addressed themselves to the constitutionality of the Act in that posture.

Following the entry of the July 25, 1969 order, petitioners filed a supplemental memorandum which did not discuss the question of legislative intent, but urged the Court to modify its order primarily by restricting the Court-decreed August 1, 1969 valuation limitation to gains, rather than both gains and losses. It was only in the answer of the State officials, filed on August 11, 1969, that the facts surrounding enactment of the Income Tax Act

were presented to the Court. That answer was filed just 3 days before the full opinion of the Court was filed on August 14, 1969.

Under the Illinois Constitution in effect in 1969 (Const. of 1870, Art. 6, § 4), the Illinois Supreme Court was to consist of 7 judges, the concurrence of 4 being necessary to a decision. Although at the time the *Thorpe* case was argued and the July 25 order was entered, there were, in fact, 7 members of the Court, Chief Justice Solfisburg and Justice Klingbiel both resigned on August 4, 1969, leaving a 5-judge court to deliver the opinion which was filed on August 14, 1969. Dissent by only 2 members of the Court would have rendered a decision impossible.

No dissent was filed, however. In that opinion, the Court upheld the tax under both the State and federal Constitutions insofar as it imposed a tax on the privilege of earning or receiving income in or as a resident of Illinois, and provided for classification of taxpayers as to rates, deductions and exemptions. However, with respect to the allegedly unconstitutional retroactive taxation of capital gains, the Court expressed "doubts as to its validity" (43 Ill. 2d 36 at 51-52, 250 N. E. 2d 633 at 641) and avoided the issue by reaffirming its order of July 25, 1969 and holding that the Act manifested a legislative intention to tax only capital gains and losses accruing after August 1, 1969. As released by the Court and as printed in the Appendix hereto, the opinion was rendered *per curiam*. However, the reports appearing at 43 Ill. 2d 36 and 250 N. E. 2d 633 show Justice House as the author. Justice House died on September 27, 1969.

Following the decision in *Thorpe*, the Illinois Department of Revenue issued Instructions and Regulations wherein it limited the effect of *Thorpe* to sales and exchanges of capital assets as defined in section 1221 of the

United States Internal Revenue Code. The instant case was then brought seeking a declaratory judgment that the scope of the *Thorpe* decision should be extended to certain other types of assets, and praying that if the Act were construed "so as to impose a tax 'upon the accumulation of or the appreciation in value of property occurring before August 1, 1969,' that the Act, in that respect, be held unconstitutional." (51 Ill. 2d 452 at 453, 283 N. E. 2d 465 at 465-466). Thus, the constitutionality of the alleged retroactivity of the Act was again presented. The trial court, basing its decision solely upon the Supreme Court's opinion in *Thorpe*, extended the scope of that decision to the assets involved in the instant case. On appeal, petitioner directly attacked the decision in *Thorpe*, presented a large body of material relevant to the question of legislative intent, and urged the Court to overrule *Thorpe* and to uphold the constitutionality of the Act despite the absence of an August 1, 1969, valuation limitation.

The Illinois Supreme Court, in a 5-2 decision, affirmed the judgment of the trial court, extended the *Thorpe* rule to the assets here involved, and stated that its decision was not based on constitutional grounds. Of the 5 judges who had decided *Thorpe*, 3 were in the majority, one (Justice House) was deceased, and one (Justice Schaefer) dissented. Justice Davis, joined by Justice Schaefer, dissented because:

> • • • The finding in *Thorpe* that the legislature intended an August 1, 1969, valuation date for the computation of capital gains and losses can have no basis other than the misapprehension that without such a finding the tax would have been retroactive and, perhaps, unconstitutional.
>
> • • • • •
>
> It seems very probable from the court's analysis in *Thorpe* that it based its findings of legislative intent

upon the assumption that to permit a basis date prior to the effective date of the Act and to permit a tax on accretions in value prior to such date would render the tax retroactive and of questionable validity. (51 Ill. 2d 452 at 459-460, 283 N. E. 2d 465 at 468-469)

The questions presented to this Court for review are the following:

1. Is there any fair or substantial support for the stated nonfederal ground of decision in this case, i.e., the court-determined legislative intent, or

2. Was the decision impelled either (a) by the Illinois Court's belief that the United States Constitution, as interpreted by this Court, requires a valuation limitation date, or (b) by the Illinois Court's attempt to evade consideration of a federal constitutional issue?

3. If the answer to question 1 is "No," and the answer to question 2 is "Yes," as petitioner submits such questions must be answered, then the fundamental question for resolution by this Court is the same as that originally posed by the petitioners in the *Thorpe* case, i.e., "if the Act is to be applied to the realization of increased value of capital assets accruing prior to August 1, 1969," is it violative of the due process and equal protection provisions of the federal Constitution. Put another way, as respondents in this case stated the question, if the Act imposes a tax "upon the accumulation of or the appreciation in value of property occurring before August 1, 1969," is it thereby rendered unconstitutional?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED.

The statutory provisions involved in this controversy are sections 102, 201, 202 and 203 of the Illinois Income Tax Act, as enacted and appearing in Chapter 120, Illinois Revised Statutes (1969), §§ 1-101, et seq. and section 203, as amended by P. A. 77-669. Each of the foregoing sections is printed in the Appendix hereto. Additionally, section 1 of the Fourteenth Amendment to the United States Constitution is involved.

ARGUMENT.

I.

THERE IS NO FAIR OR SUBSTANTIAL SUPPORT FOR THE ILLINOIS SUPREME COURT'S DECISION AS TO LEGISLATIVE INTENT.

An unsupported nonfederal ground for decision will not defeat this Court's jurisdiction.

It is clear from the majority opinion of the Illinois Supreme Court that this case was purportedly decided upon a nonfederal ground, i.e., the intent of the Illinois Legislature in enacting the Illinois Income Tax. If that ground has fair or substantial support, then this Court should not grant this petition for certiorari. However, it is established that a nonfederal ground for decision which is lacking support will not serve to deprive this Court of jurisdiction. This principle is expressed in *Wolfe* v. *North Carolina*, 364 U. S. 177, 80 S. Ct. 1482, 4 L. Ed. 2d 1650 (1960):

> It is settled that a state court may not avoid deciding federal questions and thus defeat the jurisdiction of this Court by putting forward nonfederal grounds of decision which are without any fair or substantial support. *N. A. A. C. P* v. *Alabama*, 357 U. S. 449, 455; *Staub* v. *City of Baxley*, 355 U. S. 313, 318-320; *Ward* v. *Love County*, 253 U. S. 17, 22. * * * It thus becomes this Court's duty to ascertain whether the procedural grounds relied upon by the state court independently and adequately support its judgment. (364 U. S. at 185-186)

Again, in *Watts* v. *Indiana*, 338 U. S. 49, 69 S. Ct. 1347, 93 L. Ed. 1801 (1949), the Court stated:

> * * * all those matters which are usually termed issues of fact are for conclusive determination by the State courts and are not open for reconsideration by this Court. Observance of this restriction in our review of State courts calls for the utmost scruple. But "issue of fact" is a coat of many colors. It does not cover a conclusion drawn from uncontroverted happenings, when that conclusion incorporates standards of conduct or criteria for judgment which in themselves are decisive of constitutional rights. (338 U. S. at 50-51)

In *Hooven & Allison Co.* v. *Evatt*, 324 U. S. 652, 65 S. Ct. 870, 89 L. Ed. 1252 (1945), the Court similarly held:

> * * * when the existence of an asserted federal right or immunity depends upon the appraisal of undisputed facts of record, or where reference to the facts is necessary to the determination of the precise meaning of the federal right or immunity, as applied, we are free to re-examine the facts as well as the law in order to determine for ourselves whether the asserted right or immunity is to be sustained. (324 U. S. at 659)

See, also, *Radio Station W O W* v. *Johnson*, 326 U. S. 120, 129, 69 S. Ct. 1475, 89 L. Ed. 2092 (1945).

In this case, petitioner submits that a re-examination of the undisputed facts, as they appear from the opinions in *Thorpe* and in this case, will compel this Court to conclude that the purported nonfederal ground of decision is "without any fair or substantial support."

The legislative history contradicts the Illinois Court's holding.

That the holding of the Illinois Supreme Court in *Thorpe*, reiterated in this case, finding a legislative intent to enact an August 1, 1969 valuation limitation is without any support whatsoever appears uncontrovertible from the dis-

cussion of legislative history contained in Justice Davis' dissent in this case:

> • • • If there be any doubt as to the intent of the legislature as expressed by the language employed in the Act, the abundant legislative history of the Act, referred to by the defendant, further supports the conclusion expressed above. In the hearings before the Senate Public Finance Committee held for consideration of Senate Bill 1150, which ultimately became our taxing statute, Charles W. Davis, one of the draftsmen of the Act, submitted a written statement, addressed to this particular point:
>
> > "I invite your attention to the fact that this tax, like the Federal tax, is based on annual accounting periods, and there are always items which fall in one year which may relate to what happened in other years. Thus, **there will be items of income or loss realized after August 1 which may be the result of appreciation or depreciation in value occurring before August 1—maybe years before.** Similarly, there may be net operating losses realized prior to August 1 which will provide a deduction after August through the carry-over provisions of the Federal Internal Revenue Code.
> >
> > "Some states have tried to modify this result in part by providing that, for purposes of determining gains or losses, the basis of property shall be its fair market value on the effective date of the Act, or by arbitrarily assuming that a pro rata portion of the appreciation or depreciation occurred before the effective date of the Act. However, we believe that this is neither satisfactory nor necessary. It would make administration much more difficult by departing from the federal concepts. More fundamentally, however, the concept of recognition of income for tax imposing purposes has traditionally been a 'when-*realized*' approach which has been sustained by the U. S. Supreme Court even though affected by events in prior years. There will undoubtedly be taxpayers

> whose particular facts will cause them to complain of this result, and who will point to the precedent of other states. We have carefully considered and deliberately drafted the bill in what we believe to be the fairest and most satisfactory manner."

When Senate Bill 1150 reached the House of Representatives, an attempt was made to amend it to provide, in essence, a valuation limitation date as found by the court in *Thorpe*. This attempted amendment was defeated. The legislature understood that which seems clear from the language of the Act—that no valuation limitation date, such as that imposed by the court in *Thorpe*—was intended. (51 Ill. 2d at 466-468; 283 N. E. 2d at 472-473; emphasis supplied)

The Income Tax Act itself refutes the Illinois Court's holding.

In addition to this legislative history, the specific language of the Income Tax Act refutes the Court-created legislative intent to enact an August 1, 1969 valuation limitation. The pertinent sections of the Act are set forth in Justice Davis' dissent:

> * * * Section 102 of the Act states: "Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 * * *." (Ill. Rev. Stat. 1971, ch. 120, par. 1-102.) Section 201(a) states that the tax imposed is to be measured by "net income". Section 202 thereafter defines "net income": "* * * a taxpayer's net income for a taxable year shall be that portion of his base income for such year which is allocable to this State * * *." Section 203 then defines "base income" to mean "adjusted gross income for the taxable year" in the case of individuals, and "taxable income for the taxable year" in the cases of corporations, trusts and estates. Section 203(d)(1) then

provides that: "* * * a taxpayer's gross income, adjusted gross income, or taxable income for a taxable year shall mean the amount of gross income, adjusted gross income or taxable income **properly reportable for federal income tax purposes** for the taxable year under the provisions of the Internal Revenue Code.

* * * * *

*** * * It seems apparent that the taxpayer's base income was meant to be his adjusted gross or taxable income for Federal taxation purposes except as specifically modified in section 203 of our Act. This section did not contain the specific modification imposing the August 1, 1969, valuation limitation date read into the Act by the court in Thorpe.** (51 Ill. 2d at 465-466; 283 N. E. 2d at 472; emphasis supplied)

The Illinois Court's holding is in conflict with other State decisions.

Finally, as noted by Justice Davis, the construction put upon the Illinois Income Tax Act conflicts with the construction placed upon virtually identical provisions of federally related income tax statutes by the highest courts of California, Georgia and Maryland. See, *Fullerton Oil Co.* v. *Johnson*, 2 Cal. 2d 162, 39 P. 2d 796 (1934); *Norman* v. *Bradley*, 173 Ga. 482, 160 S. E. 413 (1931), appeal dismissed *sub nom. Glenn* v. *Doyal*, 285 U. S. 526, 52 S. Ct. 404, 76 L. Ed. 923 (1932); and *Katzenburg* v. *Comptroller of Currency*, 263 Md. 189, 282 A. 2d 465 (1971). As Justice Davis stated, none of the income tax statutes before those courts contained specific mention of the federal March 1, 1913, valuation date, yet all three courts held that such date was incorporated by reference to the federal Act.

The grounds given by the Illinois Court do not support its holding.

The foregoing discussion of legislative intent is overwhelmingly persuasive to petitioner. This is not surprising, since it espouses the position which petitioner pressed upon the Illinois Supreme Court in his briefs and on oral argument. It is, however, only the view of Justices Davis and Schaefer; five other Justices adhered to the view of legislative intent expressed in the *Thorpe* case. If this Court is to hold that the majority view is without support and constitutes an attempt to avoid the federal constitutional question presented by this case, an analysis of the majority opinion is required.

The majority opinion, written by Justice Goldenhersh, who was not a member of the *Thorpe* Court, acknowledges petitioner's arguments which Justice Davis found controlling:

> The defendant Director argues that we should overrule that portion of *Thorpe* which found a legislative intent to establish an August 1, 1969, valuation limitation, and the major portion of his brief is devoted to this contention. He argues that the issue of legislative intent was not presented in *Thorpe;* that the language of the Act shows that no such valuation limitation was intended; that other legislative proposals and the Leland Committee Report all failed to provide any express valuation limitation; that the record of the hearings before the Senate Public Finance Committee fails to indicate such an intent; that a proposed amendment to the Act containing a valuation limitation was defeated; that the valuation limitation leads to "totally unrealistic economic results"; and that the valuation limitation is unfair. (51 Ill. 2d at 455; 283 N. E. 2d at 466-467)

Petitioner cannot quarrel with this summary of his position; it is complete and accurate. What, then, are the

grounds given by the Court for rejecting it? They are two in number. First, the Court stated:

> Upon consideration of the argument that in *Thorpe* we misconstrued the legislative intent, we conclude that nothing is before us in this case of which we were unaware at the time *Thorpe* was decided. (51 Ill. 2d at 456; 283 N. E. 2d at 467)

Second, the Court said:

> * * * for the further reason that the General Assembly by affirmative action has indicated its approval of our decision, *we will not now hold* that the Illinois Income Tax Act as originally enacted did not contemplate an August 1, 1969, valuation limitation. (51 Ill. 2d at 456-457; 283 N. E. 2d at 467; emphasis supplied)

This statement appears to contain tacit recognition that *Thorpe* may have been wrongly decided, but that it should not be overruled because it has been legislatively approved. Disregarding this aspect of the statement, however, do the Court's two grounds for adhering to its position with respect to legislative intent fairly support such holding? Petitioner submits that they do not.

The legislative history was not considered in Thorpe.

Petitioner's arguments were, it is true, submitted to the Court in *Thorpe* in an answer to a supplemental memorandum filed by petitioner in that case. **However, this answer was not filed until August 11, 1969, after the July 25, 1969, order of the Court had held that it was the legislative intent to enact an August 1, 1969, valuation limitation.** Thus, the Court's initial determination regarding legislative intent was made **without the benefit of any argument or evidence whatsoever on that issue.**

Moreover, the opinion ascribed to Justice House was filed

on August 14, 1969, a mere 3 days after such answer was filed. **The opinion makes absolutely no reference whatever to any of the arguments concerning legislative intent presented in that answer and listed by Justice Goldenhersh in this case.** It is an entirely reasonable inference that such opinion was written prior to the filing of such answer, and was not modified thereafter. The *Thorpe* opinion contains nothing whatsoever to show that petitioner's present arguments concerning legislative intent were considered and rejected on meritorious grounds; indeed, as Justice Davis' dissent in this case points out, no such grounds existed.

The Thorpe holding was not approved by the legislature.

Justice Goldenhersh's second ground for reiterating the *Thorpe* holding with respect to legislative intent is the asserted approval of such holding by the Illinois legislature by enactment of a 1971 amendment to section 203 of the Income Tax Act. This position is not sustainable. P. A. 77-669, which amended section 203 of the Income Tax Act and provided, in specific fashion, for an August 1, 1969, valuation limitation, shows clearly that the intention of the legislature was quite different.

First, the Supreme Court held in *Thorpe* that:

> * * * in computing a deductible loss on property acquired prior to August 1, 1969, the basis is the date of acquisition value or the August 1, 1969, value, whichever is less. (43 Ill. 2d at 54; 250 N. E. 2d at 642)

In direct opposition to this rule, section 203 of the Income Tax Act, as amended by P. A. 77-669, imposes *no limit* on the amount of a deductible loss on property acquired prior to August 1, 1969.

Second, *Thorpe* permits a taxpayer to limit gain realized on the sale of a particular asset without regard to the taxpayer's other gains and losses. Amended section 203, to the contrary, does not permit a taxpayer to reduce gain below his net capital gain for the taxable year. For example:

> In 1970 A sold 100 shares of X Company stock at a federal gain of $10,000, and also sold 100 shares of Y Company stock at a federal loss of $8,000. A's net capital gain was $2,000. Suppose that application of an August 1, 1969, valuation limitation under *Thorpe* would limit A's gain on the X Company stock to $4,000 but not affect the amount of A's loss on the Y Company stock. Under *Thorpe*, in such case, A's base income would be reduced by $6,000, the amount of gain on the X Company stock attributable to the period prior to August 1, 1969. Under amended section 203, however, A's base income would only be reduced by $2,000, the amount of A's net capital gain.

Third, nothing in *Thorpe* restricted the August 1, 1969, valuation limitation to property owned by taxpayers other than corporations. Amended section 203, to the contrary, explicitly restricts application of such a limitation to individuals, estates and trusts. Further, the *Thorpe* holding has been expressly overruled as to years beginning after 1970. The amending Act provided that *no* modifications or limitations on the amounts of income shall be taken into account except as provided by the Act.

Finally, section 2 of P. A. 77-669 provided:

> The *changes* made by the amendatory act of 1971 shall be effective for all taxable years beginning after December 31, 1970. (Emphasis supplied)

The order of the trial court in the instant case was entered on January 19, 1971, and the opinion was filed on February 4, 1971. P. A. 77-669 was adopted by the General Assembly on June 28, 1971. The variance between the

amendment and the *Thorpe* rule, as extended by the trial court, clearly demonstrate that the court's construction was not in accord with the original intent of the legislature. Had such construction been acceptable to the General Assembly, there would have been no need to effect *changes* for taxable years beginning after 1970, or to provide that no other limitations were permissible. As stated by Justice Davis:

> • • • I do not believe that this amendment is so clearly free from the coercive influence of the court's prior decision in *Thorpe*, that it can be deemed to indicate either the original legislative intent, or an intent that was not captive to the erroneous inferences in *Thorpe*. (51 Ill. 2d at 470; 283 N. E. 2d at 474)

Petitioner submits that fair or substantial support for the purported nonfederal ground of decision in this case, the Court-propounded legislative intent, is not provided by either (1) the fact that arguments with respect to legislative intent were filed with the Supreme Court *after* the July 25, 1969 Court order finding legislative intent to enact an August 1, 1969, valuation limitation—and only 3 days before the Court's opinion to the same effect, or (2) the fact that section 203 was amended in 1971 to enact a specie of August 1, 1969, valuation limitation significantly different from that enunciated in *Thorpe*.

The Illinois Court's holding was impelled by constitutional considerations.

Petitioner submits that the Court's opinion as to legislative intent in the *Thorpe* case was impelled by the Court's fear that to hold otherwise would force it to come to grips with a sticky constitutional question, a decision on which might have required it to invalidate the desperately needed income tax, or which, at the very least, might have so split

the Court as to render a decision impossible of attainment with only five sitting judges. In his opinion, Justice House gave but two reasons for finding legislative intent as he did. First, he adverted to the familiar rule that statutes will not be construed retroactively unless it clearly appears that such was the legislative intention. On this point, the opinion states:

> • • • The terms of the Code are, of course, incorporated by reference; but it is most unusual that the tax would be made prospective by such specific language and the basis date for computing gain on the sale or exchange of property should be made retroactive by such nonspecific language, particularly when the rule of statutory construction is that statutes will not be construed retroactively unless it clearly appears that such was the legislative intent. (43 Ill. 2d at 50-51; 250 N. E. 2d at 640.)

This language ignores the fact that the Act did far more than incorporate the terms of the Internal Revenue Code by reference; it expressly made "the **amount** of gross income, adjusted gross income or taxable income **properly reportable for federal income tax purposes**" the base upon which the Illinois income tax operates. No reference to a modification of such "amount" to reflect an August 1, 1969 valuation appeared anywhere in the Act, although a number of lesser modifications were specifically spelled out in section 203. The omission was clearly intentional.

More significantly, however, Justice House misconstrued the nature of an income tax in concluding that failure to incorporate an August 1, 1969, valuation limitation would render the Act "retroactive". This same misconception lies at the heart of the second stated reason for the Court's determination of legislative intent:

> • • • It is questionable that the General Assembly, by the nonspecific language which it employed, intended

> to adopt the basis dates from the Internal Revenue Code when such dates under our newly enacted Income Tax Act would raise doubts as to its validity. (43 Ill. 2d at 51-52; 250 N. E. 2d at 641.)

With respect to this point, the opinion states that "it is sufficient to quote the conclusion reached by the Iowa Supreme Court" in *City National Bank of Clinton* v. *Iowa State Tax Comm.*, 251 Ia. 603, 102 N. W. 2d 381 (1960), quoting that Court:

> • • • Although it is the rule generally recognized that revenue laws may be retroactive, it is also true that there is a point of time when such retroactivity is beyond the legislative power. (43 Ill. 2d at 52; 250 N. E. 2d at 641.)

This reliance on the *Bank of Clinton* case, however, completely overlooked the direct holding of the Iowa Supreme Court, which was that **absence of an effective date valuation limitation on capital gains and losses does not make an income tax retroactive, and hence constitutional limitations on retroactivity do not apply.** As stated by Justice Davis:

> • • • The finding in *Thorpe* that the legislature intended an August 1, 1969, valuation date for the computation of capital gains and losses can have **no basis other than the misapprehension that without such a finding the tax would have been retroactive and, perhaps, unconstitutional.** (51 Ill. 2d at 459; 283 N. E. 2d at 468; emphasis supplied)

Referring to the statement made by Justice Goldenhersh, in the instant case, to the effect that "*Thorpe* was decided without reaching the question of whether retroactive applications rendered the Act unconstitutional" (51 Ill. 2d at 456; 283 N. E. 2d at 467), as well as Justice House's declarations to that effect in *Thorpe*, petitioner submits that a careful reading of the majority and dissenting opinions leads inescapably to the conclusion that the Court, in

Thorpe, was impelled to hold as it did either (1) because it felt that such result was required by federal constitutional requirements with respect to retroactivity, or (2) because it sought to avoid the federal constitutional question. In either case, this Court has jurisdiction to decide the substantial federal question involved.

III.

THE ILLINOIS COURT'S CONSTITUTIONAL FEARS WERE GROUNDLESS.

Although petitioner believes that the holding of the Illinois Supreme Court was impelled by its concern over unconstitutional "retroactivity" of the Illinois Income Tax Act if it contained no effective date valuation limitation, such concern was based upon a misapprehension of established law. As already noted, Justice House completely overlooked the holding of *Bank of Clinton* v. *State Tax Commission*, 251 Iowa 603, 102 N. W. 2d 381 (1960), which specifically upheld the constitutionality of a tax on increases in value accruing prior to enactment but realized after enactment.

Comparable holdings have been rendered by the highest courts of California, Georgia, Kentucky, Maryland, New York and Pennsylvania. *Fullerton Oil Co.* v. *Johnson*, 2 Cal. 2d 162, 39 P. 2d 796 (1934); *Norman* v. *Bradley*, 173 Ga. 482, 160 S. E. 413 (1931), appeal dismissed *sub. nom. Glenn* v. *Doyal*, 285 U. S. 526, 52 S. Ct. 404, 76 L. Ed. 923 (1932); *Fidelity & Columbia Trust Co.* v. *Reeves*, 287 Ky. 522, 154 S. W. 337 (1941); *Katzenberg* v. *Comptroller of Treasury*, 263 Md. 189, 282 A. 2d 465 (1971); *Ebling Co.* v. *Graves*, 284 N. Y. 689, 30 N. E. 2d 726 (1940); *Commonwealth* v. *Electrolux Corp.*, 362 Pa. 333, 67 A. 2d 105 (1949).

This Court, too, has upheld the taxation of gains realized after enactment of a taxing statute but accrued prior

thereto. *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 52 S. Ct. 538, 76 L. Ed. 1083 (1932), involved the imposition in the Revenue Act of 1928 of a tax on gains realized by insurance companies on the sale or disposition of property. Such gains had been excluded from income under the Revenue Acts of 1921, 1924 and 1926. The taxpayer realized a gain on the sale of property in 1928, and contended that only gain accruing since the effective date of the 1928 Act should be taxed, either as a matter of constitutional law or as a matter of legislative construction, to avoid the constitutional issue.

This Court refused to accept the argument that the absence of a specific cross-reference to the general basis provisions in that section of the Act which subjected insurance company gains to taxation had the effect of providing for a January 1, 1928 valuation limitation, saying:

> It would be going very far in the circumstances to say that the mere omission from § 204 of a cross reference to the definition of gain in §§ 111-113, made applicable by the general provisions of the Act, not only excluded that definition from § 204, but substituted a different one not specifically mentioned in that or any other section. (286 U. S. at 254.)

Thus, refusing to duck the constitutional issue on grounds of "legislative intent", this Court upheld the tax, saying:

> • • • The tax being upon realized gain, it may constitutionally be imposed upon the entire amount of the gain realized within the taxable period, even though some of it represents enhanced value in an earlier period before the adoption of the taxing act. (286 U. S. at 250.)

Similarly, *United States* v. *Hudson*, 299 U. S. 498, 57 S. Ct. 309, 81 L. Ed. 370 (1937), upheld the imposition of a tax on gain realized by the taxpayer on the sale of silver futures on May 23 and 24, even though the statute was not

passed until June 19. Again, in *Atlantic Coast Line* v. *Daughton*, 262 U. S. 413, 43 S. Ct. 620, 67 L. Ed. 1051 (1923), this Court upheld a State income tax against the contention that "the statute is retroactive and void, because it was not enacted until March, 1922, but lays a tax based upon the net income of the [1921] calendar year."

The sole contrary authority is *State ex rel. Bundy* v. *Nygaard*, 163 Wis. 307, 158 N. W. 87 (1916), a very early case which advanced a constitutional position which this Court should now reject.

Petitioner urges this Court to hold that the decision of the Illinois Supreme Court in this case was not grounded upon a genuine nonfederal determination, and to uphold the constitutionality of the Illinois Income Tax Act without an August 1, 1969 valuation limitation.

III.

AT THE LEAST, THIS COURT SHOULD REMAND THIS CASE TO THE ILLINOIS SUPREME COURT FOR A DECISION FREE FROM CONSTITUTIONAL COMPULSION.

If this Court were to conclude, contrary to petitioner's prayer, that the record is not sufficiently clear for it to find that the Illinois Supreme Court's holding was impelled by that Court's erroneous interpretation of the constitutional considerations, then the case should be remanded. In *Department of Mental Hygiene of California* v. *Kirchner*, 380 U. S. 194, 85 S. Ct. 871, 13 L. Ed. 2d 753 (1965), this Court acknowledged that if the State court decision "rested *solely* on the Fourteenth Amendment, or, amounting to the same thing, that in striking the statute down under the State Constitution the court below acted under what it conceived to be the compulsion of the Federal Constitution," this Court would have juris-

diction. However, because it could not say that this was so, it remanded the case for further proceedings in the State court. To the same effect is *Minnesota* v. *National Tea Co.*, 309 U. S. 551, 60 S. Ct. 676, 84 L. Ed. 920 (1940).

State Tax Commission v. *Van Cott*, 306 U. S. 511, 59 S. Ct. 605, 83 L. Ed. 950 (1930), involved a situation very similar to that here. In that case, respondent contended that a decision of the Utah Supreme Court exempting him from the Utah income tax "was based squarely upon a construction of the Utah taxing statute which was held to omit respondent's salaries as a subject of taxation, and therefore that decision did not and could not reach the federal question and should not be reviewed." However, this Court held that "the opinion as a whole shows that the court felt constrained to conclude as it did because of the Federal Constitution and this Court's prior adjudications of Constitutional immunity." Having ruled that there was no such immunity under the United States Constitution, the Court remanded the case to the Utah Supreme Court so that that tribunal could decide the case under the state statute "apart from any question of Constitutional immunity."

IV.

THE DECISION OF THE ILLINOIS SUPREME COURT IS OF GREAT IMPORTANCE TO TAXPAYERS AND TAXING AUTHORITIES GENERALLY.

Although the decision of the Illinois Supreme Court in this case deals only with the Illinois Income Tax Act, it is of great potential significance to taxpayers and taxing authorities throughout the United States. According to Prentice-Hall, State and Local Taxes, All States, ¶ 1002, over half the states taxing income now use federal income in one form or another as the basic starting point for

figuring state income taxes to avoid the complexities that accompany an income tax not tied into the federal income tax rules. Further, Title II of H. R. 14370, Federal Collection of State Individual Income Taxes, as presently pending in Congress, requires a state desiring to avail itself of the Internal Revenue Service collection machinery to adopt either an income tax which is a percentage of the federal tax, or one which is based upon federal "taxable income". To the extent that the decision of the Illinois Supreme Court in this case is followed by the courts of other states the statutes of which, like that of Illinois, incorporate the provisions of the Internal Revenue Code by reference, complexity and lack of uniformity will be introduced into the national tax picture at precisely the time when both taxpayers and taxing authorities are working to reduce the burden of compliance with dissimilar statutes imposing different requirements with respect to reporting and allocation of income upon multi-state taxpayers. It is to be hoped that this unfortunate result can be avoided through a review of the instant case.

CONCLUSION.

For each of the foregoing reasons, petitioner earnestly urges that this petition be granted and that this Court's writ of certiorari issue to the Illinois Supreme Court to review its decision in this proceeding.

Respectfully submitted,

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APPENDIX.

CIRCUIT COURT ORDER OF JANUARY 19, 1971.

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
County Department—Law Division

TERRANCE R. MITCHELL, ASALEE LABORN, ERNEST J. NASSOS, JOHN A. PETERSON and FREDERICK W. WENDNAGEL, *Plaintiffs,* *vs.* GEORGE E. MAHIN, as Director of Revenue of the State of Illinois, *Defendant.*	No. 69 L 17526

ORDER.

This matter having come on for hearing on the Complaint, the Answer, the Amendment to the Answer, the Stipulation of Facts, the Amendment to the Stipulation of Facts, and the Supplemental Stipulation of Facts, and the Court having considered the briefs of the parties and having heard extended oral argument and being otherwise fully advised in the premises,

THE COURT FINDS, DECLARES, ORDERS AND DECREES:

1. An actual case or controversy exists, between each of the plaintiffs and the defendant, within the purview of the Declaratory Judgment Section of the Civil Practice Act (Ill. Rev. Stat., 1969, Ch. 110, § 57.1).

2. Each of the plaintiffs is a proper party to maintain his or her declaratory judgment action, and the issues raised by each plaintiff are properly cognizable under and contemplated by the Declaratory Judgment Section of the Civil Practice Act.

3. None of the plaintiffs has any other adequate judicial remedy under the circumstances of this case.

4. Under the circumstances in this case, it is appropriate for this Court to render a declaratory judgment with respect to the actual controversy between each of the plaintiffs and the defendant.

5. This Court declares that the Illinois Income Tax Act does not impose a tax upon the accumulation of or appreciation in the value of any property occurring before August 1, 1969.

6. On November 12, 1969, the Illinois Department of Revenue promulgated and issued written instructions for use in the preparation of 1969 individual income tax returns entitled "Instructions for Form IL-1040 1969." On February 10, 1970, the Illinois Department of Revenue promulgated and issued proposed "Regulations Regarding Determination of Net Income" under Section 202 of the Illinois Income Tax Act. To the extent those instructions and proposed regulations require the payment of Illinois income tax on the accumulation of or appreciation in the value of any property occurring before August 1, 1969, those instructions and proposed regulations are invalid.

7. Except in the cases of plaintiffs herein, in order to avoid extreme consequences in the collection of Illinois income taxes, because millions of income tax returns and instructions have been printed and distributed relating to the taxable years ending on or after August 1, 1969, the Director of Revenue is hereby authorized and directed to continue to administer the Illinois State Income Tax Act under his existing interpretations, rules and regulations, which are in issue in this case, until this case has been finally determined.

ENTER,

JUDGE DONOVAN,

Judge.

Dated:_____

CIRCUIT COURT OPINION OF FEBRUARY 4, 1971.

In the Circuit Court of Cook County, Illinois
County Department—Law Division

Terrance R. Mitchell, Asalee Laboen, Ernest J. Nassos, John A. Peterson and Frederick W. Wendnagel,
Plaintiffs,
vs.
George E. Mahin, as Director of Revenue of the State of Illinois,
Defendant.

No. 69 L 17526

OPINION.

Complainants are five Illinois taxpayers who joined in this case to seek this court's declaratory judgment pursuant to the Declaratory Judgment Section of the Illinois Civil Practice Act. (Ch. 110, Sec. 57.1, Ill. Rev. Stat. 1969). The suit arises under the Illinois Income Tax Act which became effective on August 1, 1969 and was held constitutional in *Thorpe* v. *Mahin*, 43 Ill. 2d 36 (1969). The Act is found in Ch. 120, Sec. 101, *et seq.* Specifically this case deals with Section 203 of that Act.

Three of the five plaintiffs received after August 1, 1969, the effective date of the Act, distributions from contributory profit sharing plans. The interest of each of the three said plaintiffs in those plans had vested prior to August 1, 1969 and the accumulation of, and increase in, the value of his interest had occurred before that date either in whole or in part. One of the other two plaintiffs acquired certain real estate on January 8, 1954, which he used as a farm between that date and November 21, 1969,

on which latter date he contracted for its sale. The fifth plaintiff acquired in September, 1947, an interest in real estate which he rented between that date and October 30, 1969, on which latter date he sold his interest.

In November, 1969, defendant issued certain written instructions for use by taxpayers in preparing their 1969 individual Illinois Income Tax Return, providing in part as follows:

> "Schedule F—Gains and Losses from Sales or Exchanges of Capital Assets
>
> "Schedule F should be completed by every individual reporting a sale or exchange of a Capital asset during the taxable year. This schedule provides the capital gains and losses modification (August 1, 1969 valuation limitation) to Federal adjusted gross income in arriving at base income for Illinois income tax purposes.
>
> "Definition of capital assets
>
> "For Illinois income tax purposes, the term capital assets means those assets defined in Section 1221 of the Internal Revenue Code. Only gains and losses from sales or exchanges of property defined in Section 1221 are subject to this modification for Illinois income tax purposes. There is no modification of gains or losses from the sale or exchange of property described in Section 1231 of the Internal Revenue Code, and therefore such gains or losses should not be included in Schedule F."

Each of the five plaintiffs presents a situation *not* within contemplation of Sec. 1221 and *within* contemplation of Sec. 1231 of the Internal Revenue Code. This is not disputed.

In this suit, plaintiffs seek this court's declaration that the Illinois Department of Revenue has incorrectly construed the *Thorpe* opinion to limit the non-taxability of pre-August 1, 1969 gains to stock (and other assets defined

in Section 1221 of the Internal Revenue Code). Plaintiffs seek a declaration that the *Thorpe* opinion should be construed to hold not taxable as well, pre-August 1, 1969, gains in farms and other real property used in the trade or business of the taxpayer, and pre-August 1 accumulations of funds in pension and profit-sharing plans.

In the alternative, plaintiffs seek a declaration that if the Illinois Income Tax Act requires, as the Department says that Act requires, the taxation of pre-August 1, 1969, gains from their property but the *non*-taxation of pre-August 1, 1969, gains from other property, the Act is in that respect unconstitutional, because it would then not be uniform in its application.

Defendant contends as to each plaintiff separately that (1) he is not entitled to the declaratory relief provided by Sec. 57.1 of the Civil Practice Act; (2) instructions for use in preparing 1969 returns relative to Schedule F properly construe Sec. 203(a) of the Act; and (3) so construed, the Act is not unconstitutional.

The court will first address its attention to the procedural aspects of this case. In this regard, defendant contends that: (a) the remedy of declaratory judgment is not available to plaintiffs since they have adequate remedy under the Illinois Income Tax Act and the Administrative Review Act; (b) assuming this Act for declaratory judgment is not barred, that each plaintiff has standing only to seek a declaration confined to the controversy presented by that particular plaintiff; and, (c) even if the basis for declaratory judgment is apparent in this case, this court, in that event, should, in the exercise of its judicial discretion, deny declaratory relief herein.

This court is impressed with the authorities submitted by defendant demeaning declaratory judgment as a proceeding proper and effective to invoke judicial determina-

tion of any one of the particular situations presented. However, plaintiffs do raise constitutional questions which emerge from the language and examples contained in *Thorpe,* which appear in a context of broad and general application. In this regard alone it appears that this situation is not one where this court and the Supreme Court of this State are being requested by declaratory judgment to "formulate rules broader than that necessitated by the precise situations in question" (Def's Br. pg. 19), but to the contrary, in the case at hand, as this court sees it, the question is:

> Is the rule or construction published by the Department of Revenue within the intent of the rules *already formulated* by the Illinois Supreme Court in *Thorpe?*

Defendant urges that the plaintiffs are not entitled "to the broad declarations they seek, but each plaintiff is limited, if entitled to any relief, to a declaration of the application, interpretation and validity of Section 203(a) as applied to the facts set forth in that count of the complaint applicable to him" (Def's Br. pg. 20.)

Yet, the defendant does not dispute that each of the plaintiffs is a member of the general class affected by Section 203(a), to which general class the Supreme Court has formulated rules, and to which general class, in turn, the defendant itself has formulated and issued in written instructions to all taxpayers, the broad declaration that Section 203(a) and the rules formulated by the Supreme Court relative thereto, are confined to the class of property described in Section 1221 of the Internal Revenue Code.

Defendant having asserted and published such broad declaration, construing that Section and those rules to be confined to the construction broadly declared by it, and plaintiffs, requesting a broad declaration construing that Section and those rules to comprehend the broad construc-

tion contended by them, it not only appears to this court that a cause or controversy thus exists, but the plaintiffs, who, by a proceeding for declaratory judgment, in which they seek the invocation of judicial determination as to the construction of the statute involved here, seek no more nor no greater a "broad declaration" than defendant itself has declared upon its own administrative determination.

The constant, which threads through, joins, and affects all the plaintiffs alike, is the restriction placed by defendant on the application of Section 203(a) solely to that class of property to which Section 1221 of the Internal Revenue Code applies under that code.

This court, of course, shares the concern expressed by defendant that resort to a particular procedural avenue available for resolution of problems greatly affecting the State's revenue, might well produce or permit greater delay and more interference with the collection of taxes than some other available procedure. This court agrees that the extent of revenue productivity to which a statute is amenable should, whenever possible, be encouraged, and that its impairment or restraint, be it even temporary, should, whenever possible, be discouraged, and indeed be denied where some other avenue exists which affords the ultimate relief sought, and which results in a more expeditious resolution absent the incurrence of the consequences to the State's revenue observed by defendant to be attendant to some such proceedings. Defendant likens the instant action to those which should be denied or discouraged.

However, it appears to this court that this very reason, assigned by defendant as ground worthy and sufficient for this court to reject the procedure invoked by plaintiffs here, to the contrary, by such procedure, affords those very attributes and accords those very objectives urged by defendant to be most desirable for purposes of the State's revenue.

Defendant's route, suggested beginning at the bottom of page 9 of its brief, contemplates plaintiffs (1) filing their returns pursuant to defendant's instructions; (2) whereafter plaintiffs could then file claims for refund (whereupon a lapse of time necessary for defendant's identification of, assignment of, consideration of and determination of plaintiffs' claim for refund occurs); (3) whereafter, if plaintiffs' claims are denied, notice of such denial is required to issue, protest to such decision is authorized, and if such is made, a hearing thereon is invoked (whereupon, time lapses until that hearing is concluded and again notice of that decision is required to issue); (4) whereafter, written requests for rehearing on that denial are authorized (whereupon, time again lapses until defendant's decision thereon becomes final); (5) whereafter, review under the Administrative Review Act is authorized. It is only after the accumulation and lapse of all of that time to which such administrative proceedings are susceptible that the matter finally appears for judicial consideration.

This is the procedure, defendant submits, plaintiffs be held by this court to pursue, "respecting the proper construction of various provisions" of the statute, rather than resort to, "actions for declaratory relief" because the latter remedy "enables taxpayers seriously to delay and interfere with the collection of taxes pursuant to the Income Tax Law." (Def's Br. pg. 21).

Inexplicable, however, when the two remedies are compared, is how the remedy suggested by defendant, remedies the concern expressed by defendant resulting from the remedy pursued here by plaintiffs. What does appear to this court, is that the long delay, to which resort to the administrative procedure outlined above is susceptible, before the proper construction of various provisions of the statute finally emerges for judicial consideration and determination, operates more insidiously to divert, what seems to this

court to be the real, most desirable, and most effective objective to best serve not only the State's interest, but that of all citizens and taxpayers of this state, and that is —to obtain by the *most expeditious procedure the most comprehensive determination* possible.

In the opinion of this court, it is as equally important for *all* taxpayers to know, at the very earliest opportunity, with what consequences they are faced under new Legislation, as it is for the State to insist upon the collection of those taxes from each, pending determination of those consequences to all.

Defendant does not suggest how the immediate resolution of its right to collect the tax, and the application of that resolution to the greatest number of persons affected, is more readily accomplishable by resort to the administrative procedures suggested by defendant. Rather, embarkment on such purported "adequate remedy" unerringly compels arrival at the destination necessarily reached and candidly announced by defendant, to-wit: (a) as between alternative courses, the one to be selected should be such as permits immediate collection of the tax and use of that money by the State, the while permitting resolution of any issues restricted solely in the application of that resolution to that particular individual, who finds it necessary to proceed upon an exhaustive administrative road. What does appear is that the mere recitation of the administrative procedure suggested to be followed here, supplies sufficient answer, in itself, to reject that suggestion.

Further, it is no answer to say that the administrative procedure is adequate because refund there is accompanied by interest at the rate of 6% per annum. Such recompense for the use of money to which the State may not be entitled to at all, is not recompense for the loss of opportunity to enjoy the use of that money by the person to whom it initially and at all times belonged.

The real objective which would best serve the interest of all affected parties, as this court sees it, is resolution of the question of initial entitlement to that money, resolved as immediately as possible, by a resolution determinative of the greatest number of situations invoking that question.

The instant proceeding permits such accomplishment. Plaintiffs have raised issues transcending those affecting only each of the plaintiffs individually. Plaintiffs have raised the question of the defendant's construction of the pertinent provision of the Illinois Income Tax Act, which construction delineates and restricts the application of that statute to a particular class of property, to the exclusion of its application to another class of property.

Plaintiffs are members of the class excluded. The issue they raise and submit to this court's consideration by this proceeding for declaratory judgment, is such that a determination of that issue is determinative not only as to these particular plaintiffs, but to an entire class of owners of property of which class plaintiffs are members. In addition, plaintiffs raise serious constitutional objections, the determination of which, if necessary to be reached, is likewise dispositive of those issues as to all members of that class.

It appears, under these circumstances, that the Declaratory Judgment Section of the Civil Practice Act embraces and intends that procedure here, and is superior to other methods demonstrated by defendant, or occurring to the court for the fair and efficient adjudication of the controversy here.

This court:

FINDS that an actual cause or controversy exists as contemplated by the Declaratory Judgment Section of the Civil Practice Act, Ch. 110, Sec. 57.1, Ill. Rev. Stat. (1969).

FINDS that such action lies, and such proceeding is the proper action to be maintained here.

FINDS that the issues raised are properly cognizable under and contemplated by that Section.

FINDS that the plaintiffs are proper parties to maintain this action, with standing to raise the issues raised.

FINDS that there is no adequate judicial remedy provided by the taxing statute under the circumstances of this case.

FINDS that declaratory judgment should be granted under the circumstances peculiar to this case.

We now come to consider the case on the merits.

The main issue in this case can be succinctly stated, and is not disputed by the parties to be the issue. That issue appears thusly:

> Under the provisions of the Illinois Income Tax Act and the construction of that Act by the Illinois Supreme Court in the *Thorpe* case, is the proper construction that published by defendant (modification provisions applicable only to capital assets as those assets are defined in Section 1221 of the Internal Revenue Code) or, is the proper construction the one attributed by plaintiffs (the modification of gains or losses from the sale or exchange of assets includes *all property* including that described in Section 1231 of the Internal Revenue Code).

The tax consequences resulting from application of the above construction is, as summarized by defendant on page 30 of its brief to be:

> "If gains from sales or exchanges of Sec. 1231 assets exceed losses therefrom they are treated under Sec. 1231 as though they were gains from the sales or exchanges of Sec. 1221 assets, but if losses from sales or exchanges of Sec. 1231 assets exceed the gains therefrom, they are not treated under Sec. 1231 as though they were losses from the sales or exchanges

of capital assets. They are treated as ordinary losses under said Section of the Internal Revenue Code."

First, to be observed, is the fact that the Act in question is silent as to any date to be employed in the computation of gains or losses on the subsequent disposition of property under Sec. 203 of that Act. The Illinois Supreme Court, in *Thorpe,* had directly before it the question of the legislative intent as to what date was intended to be employed in those instances. The court said at page 50, "we consider the legislative intent to be that, in the computation of capital gains and losses, the value of property acquired prior to August 1, 1969, shall, for the purpose of computation of gains or losses be limited by its value determined as of August 1, 1969."

Next to be noted is the fact that neither the Illinois Income Tax Act, Sec. 203 thereof, nor the Illinois Supreme Court in the *Thorpe* case employs any express language, words, terms or expressions referring to assets defined in Sec. 1221 of the Internal Revenue Code or assets defined in Sec. 1231 of the Internal Revenue Code, or both. It is the absence of such express language which is the distillation upon which the issues in this case have been formulated.

The Illinois Supreme Court in *Thorpe* further stated on page 53:

> "In holding the legislative intent to be that the August 1, 1969, value of property acquired before August 1, 1969, should be used in the computation of gains or losses on the subsequent disposition of that property, we simply mean that the value on that date should be used as a limitation upon the amount of gain or loss that would be computed under the Internal Revenue Code. Thus, the August 1, 1969, value cannot be used to increase either the taxable gain or the deductible loss, but it can be used to decrease the taxable gain or deductible loss, on property acquired before that date as computed under the Internal Revenue

Code upon the subsequent sale or exchange of the property."

The court immediately thereafter published examples illustrative of the application of August 1, 1969 valuation limitation. Each of those five examples used corporate stock transactions to illustrate its particular point.

Following that, the court said on page 54:

> "In short, in computing taxable gain on property acquired prior to August 1, 1969, the basis is date of acquisition value or the August 1, 1969, value, whichever is greater; in computing a deductible loss on property acquired prior to August 1, 1969, the basis is the date of acquisition value or the August 1, 1969, value, whichever is less."

The court concluded its observations and determinations by pointing out that ". . . in this opinion, the capital gains feature of this case turns on legislative intent rather than constitutional ground . . ."

The foregoing brings the issues before this court into focus.

Defendant asserts that its construction is supported by the fact that the Illinois Supreme Court in the *Thorpe* case confined its illustrations of the application of the August 1, 1969 valuation limitation "to gains and losses from the sales of corporate stocks which are Section 1221 assets under the Internal Revenue Code (*Thorpe* case, pages 53-54)." (Def.'s Br. pg. 29) In further support, defendant submits the following language of the Illinois Supreme Court found at page 50 of the *Thorpe* case:

> "The Act does not state . . . whether the basis for determining *gain or loss from the sale or exchange of a capital asset* purchased or acquired prior to August 1, 1969 should be its August 1, 1969 value or its date of acquisition value." (Emphasis supplied) (Def.'s Br. pg. 30).

Defendant submits that the employment of the specific term "capital assets" by the Illinois Supreme Court confirms the propriety of its construction confining application to Section 1221 assets.

However, what equally appears to this court from defendant's observations, and equally supported by those observations, is the conclusion, as readily resulting, that the Illinois Supreme Court by its finding that the Act does not state a base date for a *capital asset* sale or exchange thereby, and necessarily following, found that "the Act *does state* whether the basis for determining gain or loss from the sale or exchange of *all other property* purchased or acquired prior to August 1, 1969 should be its August 1, 1969 value or its date of acquisition value."

What follows is that when the Illinois Supreme Court in its opinion interchangeably employed, as it did, the terms "property" and "capital assets" and "capital gains" and "gain or loss from the sale or exchange of property," that court necessarily must have concluded that the Legislature, having intended the August 1, 1969, date to be the base date as to property other than "capital assets" intended that same date and the same treatment accorded to "capital assets" equally as well as to "all other property."

This court is, indeed, impressed with the administrative problems purported by defendant to ensue here if the legislative intent was construed to apply as plaintiffs contend rather than as defendant contends. The law is well established that the judiciary, in the construction of statutes to arrive at legislative intent, must consider the presumption that the Legislature did not intend its enactments to produce absurd results, or constructions which result in disorderliness and chaos in the administration of that enactment. Defendant submits such would follow here.

However, of equal import in arriving at the proper construction of legislative intent, and of concern to this court

in this case, is the fact that the Act itself neither expressly recites consideration of Section 1221 of the Internal Revenue Code in its application to the problem here, nor has the Illinois Supreme Court in its arrival and announcement of legislative intent recited that section, nor in either of the above instances is that section even referred to in any manner to indicate its appositeness to the delineation declared by defendant. This significant absence, considered with the employment, interchangeably, of all the terms employed by the Illinois Supreme Court in all of the contexts comprehended by that Court incisively, and in this court's opinion, decisively rejects the confined construction administratively attributed by the defendant to be that of the Legislature.

What further appears to this court to be confirmative of this conclusion, is the fact that the Illinois Supreme Court deliberately took occasion in several instances in its opinion (pages 50, 53, 54) to repeat, as that court concludes on page 54 in its opinion, that the construction determined by that court of "the capital gains feature of this case turns on legislative intent rather than constitutional grounds. . . ." The interchangeable employment, by that court, of the various terms it did employ in the consideration of that problem, strongly suggests the conclusion that the construction intended applies to "all property."

This court finds the issues in favor of the plaintiffs.

This court having predicated its decision on the foregoing grounds, it therefore is not necessary to reach plaintiffs' contention that the Act, construed as defendant would have it, would be obnoxious to various constitutional provisions as claimed by plaintiffs.

SUPREME COURT OPINION IN MITCHELL.

No. 44164

IN THE SUPREME COURT OF ILLINOIS

March Term, 1971

TERRANCE R. MITCHELL, ASALEE LABORN, ERNEST J. NASSOS, JOHN A. PETERSON and FREDERICK W. WENDNAGEL, *Plaintiffs-Appellees,* vs. GEORGE E. MAHIN, as Director of Revenue of the State of Illinois, *Defendant-Appellant.*	Appeal from the Circuit Court of Cook County, Law Division. No. 69 L 17526. Honorable Thomas C. Donovan, Judge Presiding.

OPINION FILED APRIL 17, 1972.

MR. JUSTICE GOLDENHERSH delivered the opinion of the court:

Defendant, George E. Mahin, Director of Revenue, appeals from the judgment of the circuit court of Cook County entered in plaintiffs' action for declaratory judgment. The effect of the judgment from which defendant appeals is to make applicable to the assets involved in this case the August 1, 1969, valuation date which this court, in *Thorpe* v. *Mahin*, 43 Ill. 2d 36, applied to the computation of gains or losses realized from the sale of capital assets.

In their complaint for declaratory judgment plaintiffs allege that the defendant in the "Instructions for Form IL-1040, 1969" and in Regulation 202-2(d)(1) seeks to restrict the August 1, 1969, valuation limitation to capital assets as defined in section 1221 of the Internal Revenue Code of 1954 (26 U. S. C., sec. 1221) and pray that if the Illinois Income Tax Act (Ill. Rev. Stat. 1969, ch. 120, par.

1–101, *et seq.*) is construed so as to impose a tax "upon the accumulation of or the appreciation in value of property occurring before August 1, 1969," that the Act, in that respect, be held unconstitutional.

The plaintiffs are five taxpayers, and the record contains a stipulation of the following facts.

On November 21, 1969, plaintiff John A. Peterson sold his farm for $65,000, payable $5,000 on November 21, 1969, $10,000 on March 1, 1970, and the balance in 10 equal annual installments. Throughout his period of ownership Peterson had engaged in the occupation of farming this farm. On July 31, 1969, the farm had a fair market value of $63,927.50.

On October 30, 1969, Frederick W. Wendnagel sold a one-fourth interest in improved commercial rental real estate for a net consideration of $123,497.50. He acquired this interest on September 1, 1947, and on October 30, 1969, his remaining undepreciated cost for the property was $18,487.18. On July 31, 1969, the fair market value of Wendnagel's interest in the building was $122,317.18.

Plaintiff Terrance R. Mitchell voluntarily participated in the Savings and Profit Sharing Pension Fund of Sears, Roebuck and Co. employees from June 1, 1960, to July 7, 1969, when he resigned his position and his participation in the fund ceased. On August 15, 1969, he received a lump sum distribution from the Fund of 134 shares of the stock of Sears, Roebuck and Co. and cash in the amount of $1,850.31. The shares of stock were purchased by the Fund for a total cost of $6,793.80, had a market value of $8,710 on July 31, 1969, and at the time of distribution had a market value of $9,061.75. The total of the contributions made by Mitchell to the Fund, and not withdrawn prior to August 15, 1969, was $3,805.75.

Plaintiff Asalee Laborn also participated in the Sears profit-sharing and pension fund from May 15, 1958, until

her termination as a Sears employee on September 15, 1969. On September 24, 1969, she received a lump sum distribution having a value of $9,874.84, which consisted of 110 shares of Sears stock having a value of $7,755 and cash in the amount of $2,119.84. The shares of stock were purchased by the Fund at a total cost of $4,973.10 and on July 31, 1969, had a fair market value of $7,150 and on September 24, 1969, had a fair market value of $7,755. The total of the contributions by Mrs. Laborn to the Fund and not withdrawn prior to September 24, 1969, was $2,514.

Plaintiff Ernest J. Nassos was a member of the law firm of McDermott, Will and Emery from January 1, 1966, to April 30, 1969, during which time he participated in the firm's profit sharing plan. He contributed $1,051.34 for 1966, $1,110 for 1967, $1,140 for 1968, and $210 for the part of the year ending April 30, 1969—a total contribution to the plan of $3,511.34. After August 1, 1969, he received $3,769.01 from the plan. The value of Nassos' interest in the plan on July 31, 1969, was $3,333.62.

It is further stipulated that all five plaintiffs are residents of Illinois and each of them received income during the period August 1 through December 31, 1969, which was taxable under the Illinois Income Tax Act. The parties, in the pleadings and briefs, have treated the Peterson and Wendnagel properties as assets which fall within the scope of section 1221, the Mitchell and Laborn transactions as being within the scope of section 402, and the Nassos matter as subject to sections 72 and 402 of the Internal Revenue Code of 1954. Without passing upon the correctness of the positions taken, for purposes of this opinion, we adopt them.

The defendant Director argues that we should overrule that portion of *Thorpe* which found a legislative intent to establish an August 1, 1969, valuation limitation, and the major portion of his brief is devoted to this contention. He

argues that the issue of legislative intent was not presented in *Thorpe;* that the language of the Act shows that no such valuation limitation was intended; that other legislative proposals and the Leland Committee Report all failed to provide any express valuation limitation; that the record of the hearings before the Senate Public Finance Committee fails to indicate such an intent; that a proposed amendment to the Act containing a valuation limitation was defeated; that the valuation limitation leads to "totally unrealistic economic results"; and that the valuation limitation is unfair.

The defendant's argument obviously presumes that in *Thorpe* we felt compelled to find a legislative intent to establish an August 1, 1969, valuation limitation in order to avoid constitutional problems which might stem from making the income tax applicable to appreciations in value occurring before August 1, 1969. *Thorpe* was decided without reaching the question of whether retroactive application rendered the Act unconstitutional, and the language to which defendant refers is clearly a discussion of the divergent and conflicting decisions on the subject and not a holding of this court with respect to the issue.

Upon consideration of the argument that in *Thorpe* we misconstrued the legislative intent, we conclude that nothing is before us in this case of which we were unaware at the time *Thorpe* was decided. Furthermore, after this court has construed a statute, that construction becomes, in effect, a part of the statute and any change in interpretation can be effected by the General Assembly if it desires so to do. *Susemichl* v. *Red River Lumber Co.*, 376 Ill. 138; *Kwierim* v. *Izzo*, 22 Ill. 2d 73, 80; *Schwarz* v. *Schwarz*, 27 Ill. 2d 140, 150.

The General Assembly has seen fit to express itself explicitly on the question by amending section 203 of the

Income Tax Act in which "base income" is defined (Ill. Rev. Stat. 1971, ch. 120, par. 2—203), and, with exceptions not here relevant, has enacted the August 1, 1969, valuation limitation enunciated in *Thorpe*. "While it is ordinarily assumed that an amendment is intended to change the law as it formerly existed, that assumption is not controlling. (See *Scribner* v. *Sachs*, 18 Ill. 2d 400, 411.) To ascribe such a purpose to all amendatory legislation would make it hazardous or impossible to clarify existing ambiguities so that future misinterpretation could be avoided or the recurrence of an erroneous judicial interpretation prevented." (*Roth* v. *Northern Assurance Co.*, 32 Ill. 2d 40, 50.) For the reasons stated in *Thorpe*, and for the further reason that the General Assembly by affirmative action has indicated its approval of our decision, we will not now hold that the Illinois Income Tax Act as originally enacted did not contemplate an August 1, 1969, valuation limitation.

Defendant argues that if the General Assembly "intended to establish an August 1, 1969, valuation limitation, its application should be limited to the determination of gain or loss from sales and exchanges of capital assets." This contention is based on the fact that *Thorpe* dealt only with capital assets and capital gains and losses. The decision in *Thorpe* was restricted to capital assets for the obvious reason that the issues, as formulated, involved capital assets and did not purport to consider every type of property with respect to which the issue of a valuation date might arise.

Defendant contends next that if the scope of the August 1, 1969, valuation limitation is extended to "all property" it will result in a "staggering revenue loss" and an "administrative nightmare" for the State and its taxpayers. It argues further that where "an agency charged with the administration of a legislative enactment has construed

that statute contemporaneously with the enactment thereof, that construction is entitled to great weight when determining legislative intent." Obviously, the defendant Director, not without precedent in the taxation of income, promulgated regulations designed to produce the maximum in revenue, and toward that end construed *Thorpe* as narrowly as possible in order to render the August 1, 1969, valuation date inapplicable to any capital assets except those falling within section 1221 of the Internal Revenue Code. The Director's interpretation notwithstanding, we hold the rationale of *Thorpe* to be applicable to the types of assets involved in this action. Although the parties have discussed loss carryovers, inventory assets, and installment and other accounts receivable, the record presents no issue with respect to these types of assets and this opinion does not purport to decide any questions with respect to them.

In the trial court the defendant questioned the right of the plaintiffs to maintain this declaratory judgment action because they have an appropriate remedy under the Illinois Income Tax Act and the Administrative Review Act. Defendant has abandoned this argument because "the issue here presented is one of vast importance to the State and to taxpayers generally, and is a unique issue which demands immediate resolution."

The judgment of the Circuit Court of Cook County to the extent that it holds that the August 1, 1969, valuation limitation applicable to the property here involved is affirmed.

Judgment affirmed.

MR. JUSTICE DAVIS, dissenting:

I dissent from the conclusion reached by the majority. As indicated in that opinion, the defendant Department's principal contention is that *Thorpe* (*Thorpe* v. *Mahin*, 43 Ill. 2d 36) should be overruled to the extent that the court found a legislative intent to establish an August 1, 1969, valuation limitation date. I agree with the Department in this respect.

In the briefs filed herein, the Department contends that the Illinois Income Tax Act imposes a tax measured by income, and that "income" arises only when it is realized. The fact that such income may, in part, represent gains which had accrued during years prior to the enactment of the Act, does not render the tax retroactive. The plaintiffs, on the other hand, contend that a tax on income, which includes gains in value attributable to years prior to the enactment of a taxing statute renders such a tax retroactive, and in the case of the Illinois Income Tax it would be sufficiently retroactive so as to be unconstitutional by reason of section 1 of article IX of the Illinois constitution of 1870 and the equal protection clause of the fourteenth amendment to the United States constitution.

I believe that implicit in the court's holding in *Thorpe*, in regard to the nontaxation of the total capital gain when a part thereof was attributable to an increase in value prior to August 1, 1969, was the expressed concern for the retroactive nature of such a tax and the resulting doubts thereby arising as to the validity of such a tax Act. The finding in *Thorpe* that the legislature intended an August 1, 1969, valuation date for the computation of capital gains and losses can have no basis other than the misapprehension that without such a finding the tax would have been retroactive and, perhaps, unconstitutional.

In *Thorpe,* at page 50, the court commenced the discussion of this issue by stating, "For the reasons hereafter given, ***" and it concluded the legislative intent to be that in the computation of capital gains and losses there should be an August 1, 1969, valuation limitation date. The first reason assigned was that statutes are not to be construed retroactively unless this clearly appears to be the legislative intent. The court questioned whether a tax which clearly was intended to be prospective should be made retroactive by "nonspecific language" which would permit a basis date, for purposes of computing gains and losses, prior to the effective date of the Act. It stated that when the basis of property was to be determined retroactively this should be set forth in specific language in the statute, and that our legislature's intent to do so was not clearly expressed. 43 Ill. 2d at 51.

As the second reason for finding legislative intent, the court set forth the rule that it was its duty to interpret a statute so as to avoid, if possible, a construction that would raise doubt as to its validity. On pages 51 and 52, it stated: "It is questionable that the General Assembly, by the nonspecific language which it employed, intended to adopt the basis dates from the Internal Revenue Code when such dates under our newly enacted Income Tax Act would raise doubts as to its validity." It concluded, on page 52, that whether the retroactive application of a tax was so oppressive as to transgress constitutional limitations, was a matter that had to be determined under the particular circumstances of each case. It recognized that revenue laws may be retroactive, but noted that there was a point of time when such retroactivity was beyond the legislative power.

The two foregoing reasons—a statute will not be construed retroactively unless clearly so-intended, and an interpretation will be avoided which will render the validity

of a statute in doubt—were the only ones given for the Court's finding of legislative intent. Both reasons were based upon the assumption that without the valuation limitation date for the purpose of determining basis, the tax would be rendered retroactive. From this the court concluded that the income tax statute must contain specific language which would suggest such retroactivity. Next, the court noted that our Act specifically incorporated the terms of the Internal Revenue Code, and that under the provisions thereof the basis for taxation of certain property could go back over 56 years from the date of the enactment of the Illinois Tax Act. It implied doubt as to the validity of such "retroactivity" in the revenue laws.

It seems very probable from the court's analysis in *Thorpe* that it based its finding of legislative intent upon the assumption that to permit a basis date prior to the effective date of the Act and to permit a tax on accretions in value prior to such date would render the tax retroactive and of questionable validity. The cases which the court relied upon in *Thorpe,* however, do not support this assumption. Rather, they support the opposite conclusion —that the establishment of a basis date prior to the effective date of the tax Act, does not, in fact, render it retroactive.

In *Thorpe,* the court cited *City National Bank of Clinton* v. *Iowa State Tax Com.* (1960), 251 Iowa 603, 102 N. W. 2d 381, as authority for the rule that there is a point of time beyond which revenue laws may not be retroactively applied. In *Bank of Clinton,* however, the court held that the imposition of a tax upon capital gains, including therein accretions in value prior to the effective date of the tax Act was not a retroactive tax. The court referred to those cases which held that a retroactive tax may, or may not, be constitutional, depending upon the circumstances involved. It also referred to *State ex rel. Bundy* v. *Nygaard* (1916), 163 Wis. 307, 158 N. W. 87, as sug-

gesting that a tax upon increases in value accruing prior to the enactment of the State income tax law was a retroactive tax. It then referred, however, to what it called the majority and more recent view to the contrary.

In *Bank of Clinton,* the court adopted the view that unrealized value may exist which is not taxable as income, but that it becomes taxable as income immediately upon, and only upon its realization by the owner thereof; that a tax measured by income is measured by realized gain; and that such realized gain is taxable in the year of its realization regardless of when it accrued. The rationale for the court's decision was "that such taxing act is not retroactive, that unrealized capital gains are not separate property, and that until the gain or profit is taken there is no taxable income." (251 Iowa 603, 613, 102 N. W. 2d 381, 386.) In so holding, the court indicated that it was following the views expressed in *Norman* v. *Bradley* (1931), 173 Ga. 482, 160 S. E. 413 (cited with approval in *MacLaughlin* v. *Alliance Ins. Co.* (1932), 286 U. S. 244, 76 L. Ed. 1083, 52 S. Ct. 538); *Fidelity & Columbia Trust Co.* v. *Reeves* (1941), 287 Ky. 522, 154 S. W. 2d 337; and *Fullerton Oil Co.* v. *Johnson* (1934), 2 Cal. 2d 162, 39 P. 2d 796.

In *Fullerton Oil Co.* the State tax statute referred to and incorporated therein provisions of the Federal tax statutes, as does our Act. In dealing with the question of accretions in value, the court stated: "Under the federal Income Tax Act the federal courts have established the principal that 'income' within the meaning of the Income Tax Act is 'realized gain', and that such realized gain is taxable in the year of its realization regardless of when it accrued. * * * We can see no constitutional difference between accretions to capital prior to the date of the taxing statute and those occurring subsequent thereto. If increases in the value of property constitute income, and con-

stitute income in the year in which realized rather than in the years when such increases in value accrue, it would seem that constitutionally speaking it makes no difference when such increases in value accrue—whether before or after the effective date of the taxing statute." 2 Cal. 2d 162, 168-169, 39 P. 2d 796, 798.

In *Fullerton Oil Co.* the court cited and referred to three United States Supreme Court cases (*Lynch* v. *Hornby* (1918), 247 U. S. 339, 62 L. Ed. 1149, 38 S. Ct. 543; *Helvering* v. *Canfield* (1934), 291 U. S. 163, 78 L. Ed. 706, 54 S. Ct. 368; and *MacLaughlin* v. *Alliance Ins. Co.* (1932), 286 U. S. 244, 76 L. Ed. 1083, 52 S. Ct. 538) after which it concluded: "We are of the opinion that from the standpoint of income taxes, or taxes measured by income, 'income' must be deemed to be realized gain, and that increases in value of capital assets are income in the year they are physically realized. When such increased value of capital assets came into existence is immaterial—the only question is, When was it realized?" 2 Cal. 2d 162, 171, 39 P. 2d 796, 800.

In *MacLaughlin* v. *Alliance Ins. Co.* (1932), 286 U. S. 244, 76 L. Ed. 1083, 52 S. Ct. 538, the Supreme Court, after referring with approval to the power to impose a tax upon the realization of income even though it is a result, in part, of increases in value prior to the date of the taxing act, stated: "But the constitutionality of a tax so applied, has been repeatedly affirmed and never questioned. The tax being upon realized gain, it may constitutionally be imposed upon the entire amount of the gain realized within the taxable period, even though some of it represents enhanced value in an earlier period before the adoption of the taxing act." 286 U. S. 244, 250, 76 L. Ed. 1083, 1086, 52 S. Ct. 538, 540.

In *Picchione* v. *Commissioner* (1st Cir. 1971), 440 F. 2d 170, the taxpayers sold a copyrighted item and were to

receive certain monthly payments therefor. At the time of the sale, profits from copyrighted materials were treated as long-term capital gains. Subsequently, the Internal Revenue Code was amended to exclude copyrights from the definition of capital assets under the circumstances of the taxpayers' case, and this favorable tax treatment was ended. The Act provided that the amendments were to be applicable to taxable years beginning after the date of its enactment. The court held that under the amendment, the new definition was to be used in determining the character of all payments received in taxable years beginning after its enactment, and rejected the argument that the amendment applied only to copyrights transferred after the effective date.

In *Picchione* the court stated: "Retrospective taxation, even to the extent of applying a statute to impose new tax burdens on taxable events that occurred prior to the enactment of the statute, is not necessarily unconstitutional. *United States* v. *Hudson*, 1937, 299 U. S. 498, 57 S. Ct. 309, 81 L. Ed. 370; *Brushaber* v. *Union Pac. R. R.*, 1916, 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493. To be unconstitutional, the result must be so harsh and oppressive as to amount to a denial of due process. *Welch* v. *Henry*, 1938, 305 U. S. 134, 147, 59 S. Ct. 121, 83 L. Ed. 87." 440 F. 2d 170, 173.

Finally, in the recent case of *Katzenberg* v. *Comptroller of Treasury* (1971), 263 Md. 189, 282 A. 2d 465, the court had before it the question of the taxation of receipts under an installment sale made prior to the effective date of the State income tax law. A State income tax had been in effect in Maryland for some time but, until 1967, it had not taxed capital gains. In 1967, a new State income tax law was enacted which adopted as the base for State income tax purposes the adjusted gross income of an individual taxpayer as determined under the Internal Revenue Code.

Thus, for the first time, capital gains and losses were brought within the ambit of the Maryland tax laws.

The plaintiffs in *Katzenberg* contended that the application of the State tax to the installment sale agreements constituted a retroactive tax. The court held that the tax reaches the profits received and not the earlier sale, and that it was not a retroactive tax.

It seems clear from these cases that a tax measured by income is a tax upon realized gain. The fact that a portion of the gain may be attributable to increases in value of the income-producing items prior to the effective date of the Act, or may be attributable to something done prior to such date, does not render the taxing statute retroactive so long as the gain or profit is not "realized" until after such date. Thus, where a taxpayer, such as in *Katzenberg*, elects to receive payments from the sale of property over a period of years, the taxpayer realizes the profits therefrom as the payments are made. Where he sells a product composed of labor and inventory, he receives the profit therefrom when paid. When he sells an asset, of any nature, which has increased in value prior to the effective date of the Act, he receives or realizes the income therefrom when paid. I see nothing constitutionally or equitably wrong with such result.

The plaintiffs have sought to distinguish some of the cases referred to above on the ground that our tax is one on the "privilege" of earning or receiving income as opposed to a tax upon "income." The distinction is without merit. It is not clear, from the language of the various cases dealing with the question of when income is realized, whether the particular statutes purported to tax income or the privilege of earning or receiving income. But, in *Fullerton Oil Co.* v. *Johnson* (1934), 2 Cal. 2d 162, 39 P. 2d 796, a franchise tax act which taxed the privilege of exer-

cising corporate franchises within the State "measured by their net income," was under consideration, and the court stated: "We are of the opinion that from the standpoint of income taxes, or taxes measured by income, 'income' must be deemed to be realized gain, and that increases in value of capital assets are income in the year they are physically realized." 2 Cal. 2d 162, 171, 39 P. 2d 769, 800.

Further, the court indicated in *Thorpe*, whether our tax be characterized as an income tax, or a tax on a privilege of earning or receiving income, is of little import. It there expressly disavowed the pronouncement of *Bachrach* v. *Nelson* (1932), 349 Ill. 579, that the legislature was limited in its power of taxation to adding new occupations, franchises and privileges to the list contained in section 1 of article IX of our constitution. (43 Ill. 2d 36, 45. See also: *Turner* v. *Wright* (1957), 11 Ill. 2d 161, 164-165; 64 Nw. U. L. Rev. 886 (1970).) The legislature obviously felt that it had to frame the tax as a "privilege" tax because of our prior holdings. In *Thorpe* the court upheld the income tax as a nonproperty tax.

The tax, like those in the cases cited by the defendant, is "measured by net income." As stated in *Katzenberg* v. *Comptroller of Currency* (1971), 263 Md. 189, 282 A. 2d 465, 472: "It is rather a tax measured by the yardstick of income reported for federal tax purposes * * *." I would not accept the plaintiffs' argument that if the Illinois tax is upon "adjusted gross income" which includes accretions in value during a year prior to the year the tax is imposed, that it then is either a property tax or a retroactive tax.

The fallacy in the court's holding in *Thorpe* as to the legislative intent is apparent from the language of the Act itself. Section 102 of the Act states: "Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as

when used in a comparable context in the United States Internal Revenue Code of 1954 * * *." (Ill. Rev. Stat. 1971, ch. 120, par. 1–102.) Section 201(a) states that the tax imposed is to be measured by "net income." Section 202 thereafter defines "net income": "* * * a taxpayer's net income for a taxable year shall be that portion of his base income for such year which is allocable to this State * * *." Section 203 then defines "base income" to mean "adjusted gross income for the taxable year" in the case of individuals, and "taxable income for the taxable year" in the cases of corporations, trusts and estates. Section 203(d)(1) then provides that: "* * * a taxpayer's gross income, adjusted gross income, or taxable income for a taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code."

In *Katzenberg*, the legislature chose to define income with reference to the adjusted gross income or taxable income as determined under the Internal Revenue Code. As a result, it adopted the Federal base for determining gross income, and it included capital gains and losses as taxed under Federal laws, including the March 1, 1913, valuation date. In both *Fullerton Oil Co.* v. *Johnson* (1934), 2 Cal. 2d 162, 39 P. 2d 796, and *Norman* v. *Bradley* (1931), 173 Ga. 482, 160 S. E. 413, the reference to the Federal revenue act was the only allusion to such a date. There was no specific mention of such a date, as there is none in our Act. I believe no additional reference is necessary for the tax basis of property to be determined as of a date prior to the effective date of the Act. It seems apparent that the taxpayer's base income was meant to be his adjusted gross or taxable income for Federal taxation purposes except as specifically modified in section 203 of our

Act. This section did not contain the specific modification imposing the August 1, 1969, valuation limitation date read into the Act by the court in *Thorpe*. If there be any doubt as to the intent of the legislature as expressed by the language employed in the Act, the abundant legislative history of the Act, referred to by the defendant, further supports the conclusion expressed above. In the hearings before the Senate Public Finance Committee held for consideration of Senate Bill 1150, which ultimately became our taxing statute, Charles W. Davis, one of the draftsmen of the Act, submitted a written statement, addressed to this particular point:

> "I invite your attention to the fact that this tax, like the Federal tax, is based on annual accounting periods, and there are always items which fall in one year which may relate to what happened in other years. Thus, there will be items of income or loss realized after August 1 which may be the result of appreciation or depreciation in value occurring before August 1—maybe years before. Similarly, there may be net operating losses realized prior to August 1 which will provide a deduction after August through the carryover provisions of the Federal Internal Revenue Code.
>
> "Some states have tried to modify this result in part by providing that, for purposes of determining gains or losses, the basis of property shall be its fair market value on the effective date of the Act, or by arbitrarily assuming that a pro rata portion of the appreciation or depreciation occurred before the effective date of the Act. However, we believe that this is neither satisfactory nor necessary. It would make administration much more difficult by departing from the federal concepts. More fundamentally, however, the concept of recognition of income for tax imposing purposes has traditionally been a "when-*realized*" approach which has been sustained by the U. S. Supreme Court even though affected by events in prior years. There will undoubtedly be taxpayers whose particular facts will

cause them to complain of this result, and who will point to the precedent of other states. We have carefully considered and deliberately drafted the bill in what we believe to be the fairest and most satisfactory manner."

When Senate Bill 1150 reached the House of Representatives, an attempt was made to amend it to provide, in essence, a valuation limitation date as found by the court in *Thorpe*. This attempted amendment was defeated. The legislature understood that which seems clear from the language of the Act—that no valuation limitation date, such as that imposed by the court in *Thorpe*—was intended.

On the issue of the legislative intent to establish a valuation limitation date, the majority states that nothing is before the court in this case of which it was unaware at the time of the *Thorpe* decision. However, I believe the court was not given sufficient opportunity in *Thorpe* to consider all of the arguments and authorities on this issue and the question of a retroactive tax. As the defendant points out, the original briefs filed in *Thorpe* did not consider the question of legislative intent to establish an August 1, 1969, valuation limitation date. Rather, even the petitioners in that case appeared to have assumed that no such legislative intent was expressed in the Act. Only a brief mention was made of this fact by the petitioners in *Thorpe* when they argued that Act actually taxed all capital gains realized after August 1, 1969, without excluding the portion thereof accumulated prior to that date. They urged that such taxation was discriminatory and that the entire Act was unconstitutional.

After submission of the case, this court entered an order on July 25, 1969, which contained a determination that the legislature intended to establish the August 1, 1969, valuation limitation date. The petitioners thereafter filed a supplemental memorandum addressed to this point. The

Department then filed an answer to the supplemental memorandum of the petitioners. This was the only response which the Department had an opportunity to submit to the court on this issue. It was filed with this court on August 11, 1969, just three days prior to the filing of the full opinion by the court. A review of the briefs in the two cases indicate a much more thorough presentation of this issue to the court in the present case.

Further, in arriving at what I believe to be the proper interpretation of the Act, I am aware of Senate Bill 1135, adopted by the legislature on June 28, 1971, and approved August 9, 1971, during the pendency of this action, which amends section 203 of the Illinois Income Tax Act, the section defining base income. (Ill. Rev. Stat. 1971, ch. 120, par. 2-203.) By its terms it is applicable to all taxable years commencing after December 31, 1970. The amendment modifies the definition of "adjusted gross income" in the case of individuals, and "taxable income" in the cases of corporations, trusts and estates, partially in the manner urged by the plaintiffs in this action. Distributions from qualified pension and profit-sharing plans which otherwise are included in adjusted gross income are to be deducted to the extent they are attributable to benefits which accrued prior to August 1, 1969. The amendment also uses an August 1, 1969, valuation limitation for purposes of capital gains, not limited merely to capital assets as defined in section 1221 of the Internal Revenue Code. In establishing this August 1, 1969, valuation limitation date, the amendment in essence provides for a deduction of any portion of a capital gain as shown for Federal income tax purposes which is attributable to appreciation in value prior to August 1, 1969, and also a deduction for any portion of depreciation recapture reflected in the Federal income tax figures, which is attributable to that portion of such depreciation taken prior to August 1, 1969. However, this

August 1, 1969, valuation limitation date is applicable under Senate Bill 1135, only to individuals, trusts and estates. There is no comparable valuation limitation date for corporations.

The amendment specifically sets forth its legislative intent, as follows:

> "(4) Legislative Intention. Except as expressly provided by this section, there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise." Ill. Rev. Stat. 1971, ch. 120, 2–203(4).

The subsequent amendment to the statute by the legislature might be viewed as indicating that the court's prior decision was not totally in accord with the legislative intent. (*People ex rel. Clark* v. *Village of Wheeling* (1962), 24 Ill. 2d 267, 268, 269; *People ex rel. Spitzer* v. *La Salle County* (1960), 20 Ill. 2d 18, 28; *Modern Dairy Co.* v. *Department of Revenue* (1952), 413 Ill. 55, 66.) Clearly, the subsequent amendment cannot be urged as evidencing the true original intent of the legislature because of the distinction it adopts between the tax treatment afforded corporations and that afforded individuals, trusts and estates with regard to the valuation limitation date.

The legislative action, subsequent to our opinion in *Thorpe,* seems clearly to express some concern over the interpretation or misinterpretation of the Act under *Thorpe.* If it was coerced by the court's misapprehension in *Thorpe* as to what constituted a retroactive tax, the legislature could repeal the amendment. If not, it can stand.

However, I do not believe that this amendment is so clearly free from the coercive influence of the court's prior decision in *Thorpe,* that it can be deemed to indicate either the original legislative intent, or an intent that was not captive to the erroneous inferences in *Thorpe.*

I would overrule *Thorpe* to the extent it found that the legislature intended an August 1, 1969, valuation date. As a result, I would reverse the order of the trial court declaring that the Illinois Income Tax Act does not impose a tax upon the appreciation, accretion, or accumulation in value of any property occurring before August 1, 1969, and I would hold that it was the intent of the legislature to adopt the Federal income tax structure, except as otherwise noted in the Act.

MR. JUSTICE SCHAEFER joins in this dissent.

SUPREME COURT ORDER DENYING REHEARING IN MITCHELL.

UNITED STATES OF AMERICA

STATE OF ILLINOIS } ss.
SUPREME COURT }

At a Term of the Supreme Court, begun and held in Springfield, on Monday, the eighth day of May in the year of our Lord, one thousand nine hundred and seventy-two, within and for the State of Illinois.

PRESENT: ROBERT C. UNDERWOOD, *Chief Justice*
JUSTICE WALTER V. SCHAEFER
JUSTICE DANIEL P. WARD
JUSTICE JOSEPH H. GOLDENHERSH
JUSTICE THOMAS E. KLUCZYNSKI
JUSTICE CHARLES H. DAVIS
JUSTICE HOWARD C. RYAN
WILLIAM J. SCOTT, *Attorney General*
ROBERT G. MILEY, *Marshal*
ATTEST: JUSTIN TAFT, *Clerk*

BE IT REMEMBERED, that, to-wit: on the 25th day of May, A.D. 1972, the same being one of the days of the term of Court aforesaid, the following proceedings were, by said Court, had and entered of record, to-wit:

TERRANCE R. MITCHELL, ET AL., *Appellees,* vs. GEORGE E. MAHIN, as Director of Revenue of the State of Illinois, *Appellant.*	No. 44164 — Appeal from Circuit Court, Cook County — 69 L 17526

And now, on this day, the Court having duly considered the petition for rehearing filed herein, and being now fully advised of and concerning the premises, doth overrule the prayer of the petition and denies a rehearing in this cause.

SUPREME COURT OPINION IN THORPE.

IN THE SUPREME COURT OF ILLINOIS

LEE K. THORPE and THORPE FURS, Evanston, Inc., an Illinois corporation,
Petitioners,
vs.
GEORGE MAHIN, as Director of Revenue, et al. etc.,
Respondents.

No. 42342

OPINION FILED AUGUST 14, 1969.

PER CURIAM: This is an original taxpayers' action filed pursuant to leave of this court for a declaratory judgment that the Illinois Income Tax Act (Public Act 76-261, Laws 1969, approved July 1, 1969) is invalid and seeking writs of injunction to restrain the authorities from collecting any tax under the Act and from expending any moneys for that purpose. The cause is submitted on petition, supplement to petition and the answer of the defendant State officials. In addition, we have permitted the filing of certain *amicus curiae* briefs. There is no question of fact involved.

Following oral argument heard on July 17, 1969, this court on July 25, 1969, entered an order finding and declaring the Act is not vulnerable to the constitutional challenges made by petitioners. This opinion explains the reasons for that conclusion.

The Act is comprehensive and contains the following general salient features. The tax is measured by net income and is imposed on the privilege of earning or receiving income. The rates are 2½% of the net income of individual,

trust or estate taxpayers and 4% of the net income of corporate taxpayers. Net income is computed for individuals by taking the adjusted gross income from the Federal income tax return, with certain adjustments, less a standard deduction of $1,000 for each taxpayer and an additional $1,000 exemption for each exemption in excess of one for the taxpayer's spouse, additional $1,000 exemptions for the taxpayer or spouse who is blind or 65 years of age or over and a like amount for each dependent. Net income for corporations is computed by taking the base income, which is Federal taxable income, making certain adjustments, and deducting the standard exemption of $1,000. Further references to the Act will be made as required for an understanding of the questions posed.

The first question concerns the nature of the tax. Petitioners argue that it is a property tax; that, as such, it is subject to the limitations of article IX of our constitution concerning a property tax; and that among the constitutional limitations the tax transcends is the one requiring a property tax to be levied by valuation on every person and corporation. Respondents, on the other hand, argue that the tax is a nonproperty tax and not subject to the constitutional limitations article IX imposes on a property tax.

Petitioners in support of their argument place strong reliance on *Bachrach* v. *Nelson*, 349 Ill. 579, which involved the constitutionality of "an act in relation to a tax upon persons and fiduciaries based upon income." In considering the nature of the income tax there imposed, the court proceeded on the basis that "income" is "property" and concluded that a tax on income "is a tax upon the property itself." (349 Ill. 579, 591-596.) It then held the tax unconstitutional because "It is a proposed tax on property by graduation rather than by valuation." 349 Ill. 579, 596.

In arriving at its conclusion that a tax on income is a tax on property the court in *Bachrach* relied heavily in form, theory and conclusion on *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 15 S. Ct. 673, 39 L. Ed. 759 (modified on rehearing, 158 U. S. 601, 15 S. Ct. 912, 39 L. Ed. 1108), and quoted from *Pollock* as follows: "The name of the tax is unimportant. The real question is, is there any basis upon which to rest the contention that real estate belongs to one of the two great classes of taxes, and the rent or income which is the incident of its ownership belongs to the other? We are unable to perceive any ground for the alleged distinction. An annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on the real estate, which would be paid out of the rent or income." 349 Ill. 579, 595, quoting from 157 U. S. 429, 580-581, 15 S. Ct. 673, 689, 39 L. Ed. 759, 819.

In *New York ex rel. Cohn* v. *Graves*, 300 U. S. 308, 57 S. Ct. 466, 81 L. Ed. 666, it became clear that *Pollock* could no longer, if it ever did, stand for the proposition that a tax on income derived from property is a tax on property. In *Cohn* the Supreme Court held that the State of New York could impose a tax upon a New York resident measured by rental income received from real estate in New Jersey. In analyzing the nature of a tax on income and a tax on its source the court observed: "Neither analysis of the two types of taxes, nor consideration of the bases upon which the power to impose them rests, supports the contention that a tax on income is a tax on the land which produces it. The incidence of a tax on income differs from that of a tax on property. Neither tax is dependent upon the possession by the taxpayer of the subject of the other. His income may be taxed, although he owns no property, and his property may be taxed, although it produces no income. The two taxes are measured by different standards,

the one by the amount of income received over a period of time, the other by the value of the property at a particular date. Income is taxed but once; the same property may be taxed recurrently. The tax on each is predicated upon different governmental benefits; the protection offered to the property in one state does not extend to the receipt and enjoyment of income from it in another." (300 U. S. 308, 314, 57 S. Ct. 466, 468, 81 L. Ed. 666, 671.) The court also pointed out that *Pollock* was not based "upon the ground that the tax was a tax on the land." 300 U. S. 308, 315, 57 S. Ct. 466, 468, 81 L. Ed. 666, 672.

The court in *Bachrach* also implied that the "overwhelming weight of judicial authority" holds that an income tax is a property tax. (349 Ill. 579, 591-595.) We have reviewed the many State cases dealing with this question and find the weight of authority to be that an income tax is not a property tax. Without citing or discussing the numerous cases that have passed on the issue, we feel it is sufficient to quote the conclusions reached by others as to the weight of authority.

In *Hale* v. *Iowa State Board of Assessment and Review*, 302 U. S. 95, 58 S. Ct. 102, 82 L. Ed. 72, the Supreme Court observed: "The question as to the nature of such a tax has come up repeatedly under state constitutions requiring taxes upon property to be equal and uniform, or imposing similar restrictions. Many, perhaps most, courts hold that a net income tax is to be classified as an excise. [Citing cases.] 'The tax levied on income is not a property tax, • • •' [Citing cases.] • • • True, there are courts in other states that teach a different doctrine. [Citing cases including Bachrach.]" (302 U. S. 95, 104-05, 58 S. Ct. 102, 105, 82 L. Ed. 72, 78.) "While there is authority to the effect that an income tax is a 'property tax', and that a tax on the income from property is a tax on the property,

the view generally taken is that an income tax is not a tax on property, but is more within the category of excise taxes, and that a tax on income is not a tax on the source of the income." (85 C. J. S., Taxation, sec. 1089.) "The prevailing view appears to be that an income tax is not a tax on 'property' within the meaning of such provisions." (State constitutional provisions governing property taxes.) 27 Am. Jur., Income Taxes, sec. 19.

The court in *Bachrach* also completely ignored the decision of *Young* v. *Illinois Athletic Club*, 310 Ill. 75, in which it was held that a tax upon the income from property was not a tax imposed upon an interest in real estate. In *Young* it was stated: "An income tax is not similar to other forms of taxation, since it is not imposed upon property or business but upon the proceeds arising therefrom. (Black on Income and Other Federal Taxes, sec. I.) An income tax is an assessment upon the income of the person and not upon any particular property from which that income is derived." 310 Ill. 75, 80-81.

As the Supreme Court observed in *Cohn*, the income tax differs from a property tax as to its incidence, its measure, the recurrence of the tax on the same subject, and the governmental benefits on which it is predicated. Professor Magill puts it this way. "Hence, a tax upon incomes appears to be quite a different tax from one upon property. In the parlance of corporation finance, the one utilizes an income statement, the other a balance sheet. The taxes are laid upon quite different subjects, and will yield quite different results." (Magill, Taxable Income, 223, Rev. Ed. 1945.) We agree with this analysis.

We hold that the tax in question is not a property tax and therefore does not come within the limitations article IX of our constitution imposes on property taxes. The holding in *Bachrach* v. *Nelson*, 349 Ill. 579; *Ohio Oil Co.* v. *Wright*, 386 Ill. 206, and *Friedrich* v. *Wright*, 386 Ill. 229 that an "income tax" is a "property tax" and subject to

the limitations article IX places on property taxes, is overruled.

Petitioners contend that our constitution prohibits the passage of an income tax. This contention begins with the broad dictum of *Bachrach* that article IX limits the taxing power of the General Assembly to (1) property taxes on a valuation basis; (2) occupation taxes; and (3) franchise or privilege taxes. They point out that the present tax is obviously not a franchise or occupation tax and that if it is not a property tax, then it must be considered a privilege tax to be sustained. It is then argued that the right to earn or receive income is not a privilege and cannot be taxed as a privilege. They conclude from this that the General Assembly is without authority to enact the tax in question.

In *Turner* v. *Wright,* 11 Ill. 2d 161, we observed: "It has been authoritatively said that '[m]any years of litigation have not resolved the uncertainties and ambiguities in the nonproperty provisions of sections 1 and 2' of article IX of the constitution. (Cushman, Proposed Revision of Article IX, 1952 Ill. Law Forum, 226, 237.) Section 2 provides: 'The specification of the objects and subjects of taxation shall not deprive the general assembly of the power to require other subjects or objects to be taxed in such manner as may be consistent with the principles of taxation fixed in this constitution.' This provision of the revenue article of the constitution has received varying interpretations. See, *e.g., Illinois Central Railroad Co.* v. *County of McLean,* 17 Ill. 291; *People* v. *Worthington,* 21 Ill. 170; *Raymond* v. *Hartford Fire Insurance Co.,* 196 Ill. 329; *Harder's Fire Proof Storage and Van Co.* v. *City of Chicago,* 235 Ill. 58; *Bachrach* v. *Nelson,* 349 Ill. 579; *Reif* v. *Barrett,* 355 Ill. 104; *Johnson* v. *Halpin,* 413 Ill. 257." (11 Ill. 2d 161, 165-166.) After making this observation, it was concluded that "the uncertainty that has persisted as to the precise

scope of section 2 of article IX need not trouble us in this case." 11 Ill. 2d 161, 166.

The uncertainty referred to in *Turner* is this: Does section 2 only "permit the General Assembly to add new occupations, franchises and privileges to the list specifically designated for taxation" in section 1, as stated in *Bachrach* (349 Ill. 579, 587), or does it mean "that the General Assembly is not deprived of power to tax other objects or subjects of taxation than those enumerated in section 1," as stated in *Harder's Fire Proof Storage and Van Co.* v. *City of Chicago*, 235 Ill. 58, 73. Until this observation of uncertainty was made in *Turner*, it would seem that it was generally accepted that the only nonproperty taxes that could be levied were occupation taxes, privilege taxes and franchise taxes. (See Cushman, Proposed Revision of Article IX, 1952 Ill. Law Forum, 226, 237.) The dictum of *Bachrach* apparently was accepted because the legislature laid subsequent nonproperty taxes on a "privilege" basis and the issue in subsequent cases was whether the subject of the tax was a privilege. (See *e.g.*, *Johnson* v. *Halpin*, 413 Ill. 257; *Turner* v. *Wright*, 11 Ill. 2d 161.) The broad definition given to "privilege" as used in section 1 of article IX (see *e.g.*, *Johnson* v. *Halpin*, 413 Ill. 257; *Turner* v. *Wright*, 11 Ill. 2d 161), avoided the restrictive force of the *Bachrach* dictum, and the legislature continued to enact new taxes on a privilege basis.

The dictum of *Bachrach* has been severely questioned in this case, however. Professor Philip B. Kurland of the University of Chicago Law School, Professor John C. O'Byrne of Northwestern University School of Law and Professor J. Nelson Young of the University of Illinois College of Law have filed an *amicus curiae* brief to call to our "special attention an historical study of exceptional scholarship which was completed after the decision in *Bach-*

rach." The study is "Nonproperty Taxes under the Illinois Constitution," 25 U. of Chi. L. R. 63 (1957), written by Professor Jo Desha Lucas of the University of Chicago Law School. The author in an in-depth study of the history of sections 1 and 2 of article IX and an analysis of the many cases of this court interpreting these sections concluded that under section 2, the legislature has unlimited authority in the selection of subjects and objects other than property for taxation. The *amici curiae* concur in this conclusion. Professor Rubin G. Cohn of the University of Illinois College of Law in "Constitutional Limitations on Income Taxation in Illinois," 1961 Ill. Law Forum, 586, notes that *Bachrach* has been declared wrong on its history and logic by Professor Lucas and then states, on page 612: "It has been the purpose of this article to suggest that in its logic it has been drastically modified, if indeed not overruled, by subsequent decisions."

The extensive analysis devoted to the correctness of the *Bachrach* dictum concerning nonproperty taxes by Professor Lucas in his 45-page article and by Professor Cohn in his 37-page article cannot, of course, be repeated in even an abbreviated form. It is sufficient to say that we basically agree with the major conclusion reached in each article. The decisions previous to *Bachrach* did not support the dictum (see, *e.g.*, *Harder's Fire Proof Storage and Van Co.* v. *City of Chicago*, 235 Ill. 58) and decisions since *Bachrach* have eroded the underlying theory of the dictum. See, *e.g.*, *Reif* v. *Barrett*, 355 Ill. 104; *Johnson* v. *Halpin*, 413 Ill. 257; *Turner* v. *Wright*, 11 Ill. 2d 161.

Section 2 of article IX means just what it says. "The specification of the objects and subjects of taxation shall not deprive the general assembly of the power to require other subjects or objects to be taxed in such manner as may be consistent with the principles of taxation fixed in this

constitution." The statement in *Bachrach* v. *Nelson*, 349 Ill. 579; *Reif* v. *Barrett*, 355 Ill. 104; *Village of Lombard* v. *Illinois Bell Telephone Co.*, 405 Ill. 209; and *Johnson* v. *Halpin*, 413 Ill. 257, that sections 1 and 2 of article IX of our constitution limit the General Assembly to property taxes, occupation taxes and franchise or privilege taxes is disavowed.

We hold that under section 2 of article IX of our constitution the General Assembly has the power to impose a tax on the privilege of earning or receiving income in or as a resident of Illinois.

It is next contended that the Act violates the uniformity provision of section 1 of article IX of our constitution and the equal-protection and due-process requirements of the fourteenth amendment to the United States constitution by creating multiple classes and discriminating unreasonably among them. This contention is advanced specifically against the provisions which tax corporations at a 4% rate and individuals, trusts, and estates at a 2½% rate.

Both the equal-protection argument and the uniformity argument depend on the reasonableness of putting corporations in one class and individuals, trusts, and estates in another class for purposes of this tax. (See *Grenier & Co.* v. *Stevenson*, 42 Ill. 2d 289.) When the due-process contention has been advanced, this court, citing Supreme Court cases, has stated: "It has long been settled that the power of the legislature to make classifications, particularly in the field of taxation, is very broad, and that the fourteenth amendment imposes no 'iron rule' of equal taxation. [Citations.] The reasons justifying the classification, moreover, need not appear on the face of the statute, and the classification must be upheld if any state of facts reasonably can be conceived that would sustain it. [Citations.] The burden therefore rests on one who assails the statute to negate the exist-

ence of such facts. [Citations.]" *Department of Revenue* v. *Warren Petroleum Corp.*, 2 Ill. 2d 483, 489-490.

When the uniformity contention has been advanced this court has stated: "It is well established that the legislature has broad powers to establish reasonable classifications in defining subjects of taxation. • • • Such classification must, however, be based on real and substantial differences between persons taxed and those not taxed. [Citations.]" (*Klein* v. *Hulman*, 34 Ill. 2d 343, 346-347.) "In order to prevail on an allegation that a statute or portion of a statute is unconstitutional, the plaintiff has the burden of showing how the legislature has violated the constitution." *Grenier & Co.* v. *Stevenson*, 42 Ill. 2d 289, 291.

In short, petitioners have the burden of showing that the challenged classification is unreasonable. Their only assertion is that "corporations are at a disadvantage when they compete in the same type of business with individual proprietorships or partnerships because of the rate differential." This assertion has been rejected by the Supreme Court as to a Federal tax (*Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 31 S. Ct. 342, 55 L. Ed. 389), and as to a State tax (*Fort Smith Lumber Co.* v. *Arkansas ex rel. Arbuckle*, 251 U. S. 532, 40 S. Ct. 304, 64 L. Ed. 396), and by this court (*People* v. *Franklin National Insurance Co. of New York*, 343 Ill. 336; *Michigan Millers Mutual Fire Insurance Co.* v. *McDonough*, 358 Ill. 575), where, for purposes of the tax in question, corporations were placed in one class and individuals in another and each were taxed differently.

In *Flint* v. *Stone Tracy Co.*, the Supreme Court stated: "The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of

those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business, without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships. It is this distinctive privilege which is the subject of taxation, not the mere buying or selling or handling of goods, which may be the same, whether done by corporations or individuals." 220 U. S. 107, 161-2, 31 S. Ct. 342, 353, 55 L. Ed. 389, 417-8.

Thus the rationale of *Flint* v. *Stone Tracy Co.* is that there are sufficient differences "which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals" to justify a tax on corporations measured by income, without a similar tax being imposed on individuals. In like manner, we feel there are sufficient differences between the privilege of earning or receiving income as a corporate entity and the privilege of earning or receiving income as an individual, trust or estate to justify their being taxed at a different rate.

The uniformity, equal-protection and due-process arguments are also advanced against the standard exemption provisions allowing a $1,000 exemption for each taxpayer (sec. 204(b)) and in the case of individuals "an additional amount of $1,000 for each exemption in excess of one allowable to such individual for the taxable year under section 151 of the Internal Revenue Code." (Sec. 204(c).) Petitioners argue that these provisions create numerous classifications which are unreasonable and arbitrary.

The classes created under the exemption provisions can be sustained as reasonable under a number of theories. It is sufficient to note that petitioners advance no theory as to the unreasonableness of the classifications for exemption. Such exemptions have been upheld under the Federal income tax act (*Brushaber* v. *Union Pacific Railroad,* 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493), and under our Inheritance Tax Act. *Kochersperger* v. *Drake,* 167 Ill. 122.

It is stated by petitioners that "Taxpayers engaged in business (whether corporations, partnerships or individual proprietorships) are allowed certain deductions (such as charitable deductions), which are denied to taxpayers not engaged in business" and that this is a discrimination violating due process and equal protection. There is no elaboration on the point and it is hard to follow. Nothing is called to our attention, nor do we find anything, to justify the assertion of a different treatment of charitable deductions for individual taxpayers in business and individual taxpayers not in business. There is a difference, of course, between individuals (whether or not engaged in business) and corporations. Corporations are taxed on Federal taxable income with modifications while individuals are taxed on Federal adjusted gross income with modifications. Under the Act, unlike the Code, individual taxpayers in business (who report on schedule 1040C under the Code) may only deduct business expense and neither business individual taxpayers nor nonbusiness individual taxpayers may make deductions for charitable contributions, while corporations under section 170(b) of the Code may deduct charitable contributions of not to exceed 5% (with carry-over privileges). As we have heretofore indicated, individuals and corporations may bear different classifications so long as the classifications are reasonable and consistent with the rule of uniformity. As to other itemized personal deduc-

tions (allowed to individuals but not corporations under the Code,) neither individuals nor corporations may deduct them under the Act.

It is suggested that the Act delegates the General Assembly's law making power to the Congress of the United States because of numerous references to the Internal Revenue Code, particularly section 102 of the Act (the construction section) which reads: "Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 and other provisions of the statutes of the United States relating to federal income taxes *as such Code and statutes are in effect on the date of enactment of this Act.*" (Emphasis supplied.) There is some scholarly opinion, as well as case law from other jurisdictions, that the legislature could adopt a statute providing that future modifications of the Code would have consequences in the meaning and application of the Act. (See Young, "Report of the Commission on Revenue," 1963, at pages 373 *et seq.*). But, we are not here faced with that problem because the italicized portion of section 102 of the Act specifically adopts the terms of the Code as they existed at the time of its enactment and does not contemplate that subsequent changes in the Code shall be automatically applied to the Act.

It has been held that a State statute adopting, by reference, existing provisions of the Code as to the amount of income or what shall constitute income for tax purposes, is not unconstitutional as a delegation of legislative powers. (See, *e.g.*, *Featherstone* v. *Norman*, 170 Ga. 370, 153 S. E. 58; *Santee Mills* v. *Query*, 122 S. C. 158, 115 S. E. 202.) We are of the opinion that adoption of the terms of the Code, which are not expressly spelled out in the Act, in no way

constitutes an unconstitutional delegation of legislative power.

It is next urged that the stated subject of the Act is income and the Act either fails to express its subject at all or embraces more than one subject in violation of section 13 of article IV of the constitution, and further provides for taxation of property without including that subject in the title of the Act. This is predicated upon the holding in *Bachrach* that an income tax is a property tax within the meaning of section 1 of article IX. In the view we have taken of the *Bachrach* case this point has no validity. But, it is further suggested that even if *Bachrach* is overruled, a problem remains in section 13 of article IV because unrealized capital appreciation accruing prior to the effective date of the Act is property, not income. This poses no problem as will presently appear.

Petitioners argue that if the Act is to be applied to the realization of increased value of capital assets accruing prior to August 1, 1969, they would thereby be deprived of property without due process of law and be denied equal protection of the law. For the reasons hereafter given, we consider the legislative intent to be that, in the computation of capital gains and losses, the value of property acquired prior to August 1, 1969, shall, for the purpose of computation of gains or losses be limited by its value determined as of August 1, 1969.

First, we have the familiar rule that statutes will not be construed retroactively unless it clearly appears such was the legislative intention. (*United States Steel Credit Union* v. *Knight*, 32 Ill. 2d 138; *Hogan* v. *Blecker*, 29 Ill. 2d 181; *Nelson* v. *Miller*, 11 Ill. 2d 378.) The Act is clear, indeed it expressly provides, that the tax shall operate prospectively beginning August 1, 1969. The Act does not state, however, whether the basis for determining gain or loss from the sale

or exchange of a capital asset purchased or acquired prior to August 1, 1969, should be its August 1, 1969, value or its date of acquisition value. The terms of the Code are, of course, incorporated by reference; but it is most unusual that the tax would be made prospective by such specific language and the basis date for computing gain on the sale or exchange of property should be made retroactive by such nonspecific language, particularly when the rule of statutory construction is that statutes will not be construed retroactively unless it clearly appears such was the legislative intent. Furthermore, whether certain property is a capital asset or not and the holding period involved, lose much of their significance under the Act because long term capital gains are taxed the same as ordinary income under our Act.

The Internal Revenue Code (I. R. C. 1954, sec. 1053) and the statutes in a number of States expressly provide that, where property was owned on or acquired prior to the date on which incomes first became subject to taxation, its value on such date shall be taken as the basis of determining profit or loss from its subsequent disposition. (See, *e.g.*, *State* v. *Flenner*, 236 Ala. 228, 181 So. 786; *Brown* v. *Long*, 242 Mass. 242, 136 N. E. 188; *Fernwood Lumber Co.* v. *Mississippi State Tax Com.*, 167 Miss. 273, 149 So. 727; *Vale* v. *DuPont*, 37 Del., 254, 182 Atl. 668; *Bundy* v. *Nygaard*, 163 Wis. 307, 158 N. W. 87; *City National Bank of Clinton* v. *Iowa State Tax Com.*, 251 Ia. 603, 102 N. W. 2d 381; *State* v. *Stickney*, 213 Minn. 89, 5 N. W. 2d 351; *Fullerton Oil Co.* v. *Johnson*, 2 Cal. 2d 162, 39 P. 2d 796; but *cf. Fidelity & Columbia Trust Co.* v. *Reeves*, 287 Ky. 522, 154 S. W. 2d 337; *Norman* v. *Bradley*, 173 Ga. 482, 160 S. E. 413.) Where the basis of the property was to be determined retroactively from the effective date of an amendment to the income tax statute, other States have done it with specific language. (See, *e.g.*, *City National*

Bank of Clinton v. *Iowa State Tax Com.*, 251 Ia. 603, 102 N. W. 2d 381; *Fullerton Oil Co.* v. *Johnson*, 2 Cal. 2d 162, 39 P. 2d 796; *People* v. *Graves*, 280 N. Y. 405, 21 N. E. 2d 371.) Our legislature's intent on this matter has not been clearly expressed in the manner in which it was in the cited cases.

Second, we have the equally familiar rule that "It is our duty so to interpret the statute as to promote its essential purposes and to avoid, if possible, a construction that would raise doubts as to its validity." (*People* v. *Nastasio*, 19 Ill. 2d 524, 529; *Pliakos* v. *Illinois Liquor Control Com.*, 11 Ill. 2d 456; *People* v. *Dale*, 406 Ill. 238.) It is questionable that the General Assembly, by the nonspecific language which it employed, intended to adopt the basis dates from the Internal Revenue Code when such dates under our newly enacted Income Tax Act would raise doubts as to its validity.

In *Welch* v. *Henry*, 305 U. S. 134, 59 S. Ct. 121, 83 L. Ed. 87, the Supreme Court stated: "In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation." (305 U. S. 134, 147, 59 S. Ct. 121, 126, 83 L. Ed. 87, 93.) Without discussing and analyzing the various circumstances referred to in *Welch* v. *Henry* and the cases cited therein, as well, as, various circumstances and results of cases from other State courts (such analysis may be found in cases such as *Fullerton Oil Co.* v. *Johnson*, 2 Cal. 2d 162, 39 P. 2d 796; *Fidelity & Columbia Trust Co.* v. *Reeves*, 287 Ky. 522, 154 S. W. 2d 337 and *City National Bank of Clinton* v. *Iowa State Tax Com.*, 251 Ia. 603, 102 N. W. 2d 381) we feel it is sufficient to quote the conclusion reached by the Iowa Supreme Court: "This is the first case of that nature before our court, but the question has been raised in the federal as well as several

state courts, with a sharp difference of opinion, not only between different jurisdictions, but even among the members of the courts in those jurisdictions. It is not unusual to find 4 to 4, or 4 to 3, decisions on this question. Although it is the rule generally recognized that revenue laws may be retroactive, it is also true that there is a point of time when such retroactivity is beyond the legislative power." *City National Bank of Clinton* v. *Iowa State Tax Com.*, 251 Ia. 603, 102 N. W. 2d 381, 383; see also, 27 Am Jur., Income Taxes, sec. 27; 85 C. J. S., Taxation, sec. 1090 (d).

If the basis dates of the Internal Revenue Code were incorporated, the basis for some property could go back over 56 years from the date the Illinois income tax first became effective. As the Supreme Court stated: "Whether or not such accretions [increased value of assets attributable to and accrued before the first Federal law taxing income of individuals] may be constitutionally subjected to tax, we have no occasion to decide. The present act, at least, does not attempt it." *Lucas* v. *Alexander*, 279 U. S. 573, 577, 49 S. Ct. 426, 428, 73 L. Ed. 851, 854.

In holding the legislative intent to be that the August 1, 1969, value of property acquired before August 1, 1969, should be used in the computation of gains or losses on the subsequent disposition of that property, we simply mean that the value on that date should be used as a limitation upon the amount of gain or loss that would be computed under the Internal Revenue Code. Thus, the August 1, 1969, value cannot be used to increase either the taxable gain or the deductible loss, but it can be used to decrease the taxable gain or deductible loss, on property acquired before that date as computed under the Internal Revenue Code upon the subsequent sale or exchange of the property.

The following examples will illustrate the application of the August 1, 1969, valuation limitation.

1. August 1, 1969, valuation cannot be used to increase taxable gain. Stock purchased on April 1, 1968, at $10 has a value of $5 on August 1, 1969, and is sold for $10 on October 1, 1969. There is no gain. See *Walsh* v. *Brewster*, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762.

2. August 1, 1969, valuation cannot be used to increase deductible loss. Stock purchased on April 1, 1968, at $10 has a value of $15 on August 1, 1969, and is sold for $10 on October 1, 1969. There is no loss. See *United States* v. *Flannery*, 268 U. S. 98, 45 S. Ct. 420, 69 L. Ed. 865.

3. August 1, 1969, valuation can be used to decrease taxable gain. Stock purchased on April 1, 1968, at $10 has a value of $15 on August 1, 1969, and is sold for $20 on October 1, 1969. The taxable gain is $5. See *Goodrich* v. *Edwards*, 255 U. S. 527, 41 S. Ct. 390, 65 L. Ed. 758.

4. August 1, 1969, valuation can be used to decrease deductible loss. Stock purchased on April 1, 1968, at $15 has a value of $10 on August 1, 1969, and is sold for $5 on October 1, 1969. The deductible loss is $5. See *Heiner* v. *Tindle*, 276 U. S. 582, 48 S. Ct. 326, 72 L. Ed. 714.

A fifth illustration, which is a combination of examples 1 and 4, occurs when stock is purchased on April 1, 1968 at $20, has a value of $10 on August 1, 1969, and is sold for $15 on October 1, 1969. There is no gain. (See *Goodrich* v. *Edwards*, 255 U. S. 527, 41 S. Ct. 390, 65 L. Ed. 758.) There is no deductible loss. See *Heiner* v. *Tindle*, 276, U. S. 582, 48 S. Ct. 326, 72 L. Ed. 714.

In short, in computing taxable gain on property acquired prior to August 1, 1969, the basis is date of acquisition value or the August 1, 1969, value, whichever is greater; in computing a deductible loss on property acquired prior to August 1, 1969, the basis is the date of acquisition value or the August 1, 1969, value, whichever is less.

The parties seem to be in agreement that the severability section of the Act (section 1601) may be applied in the event we find retroactive treatment of capital gains to be unconstitutional. However, as pointed out in our order of July 25, 1969, and in this opinion, the capital gains feature of this case turns on legislative intent rather than constitutional grounds so that determination of the application of separability is not required.

The judgment order of July 25, 1969, for the reasons herein given, is hereby confirmed.

Judgment for respondents.

SUPREME COURT ORDER OF JULY 25, 1969.

IN THE SUPREME COURT OF ILLINOIS.

No. 42342.

LEE K. THORPE and THORPE FURS, EVANSTON, INC., an Illinois corporation,
Petitioners,
vs.
GEORGE MAHIN, as Director of Revenue, et al., etc.,
Respondents.

Original Proceedings for Declaratory Judgment and Writs of Injunction.

ORDER.

It is the opinion of the Court that the Illinois Income Tax Act (Public Act 76-261, Laws 1969, approved July 1, 1969; effective August 1, 1969), is a valid enactment insofar as it is challenged in this cause.

It is therefore declared and ordered that Public Act 76-261, Laws 1969, is not vulnerable to the constitutional challenges made by petitioners in this cause and is a valid and constitutional enactment in respect to those challenges. In this conclusion we consider the legislative intent to be that, in the computation of capital gains and losses, the value of property acquired prior to August 1, 1969, shall, for the purpose of computation of capital gains or losses be determined as of August 1, 1969.

A written opinion will follow.

STATUTE INVOLVED.

Sections 102, 201, 202 and 203, as amended by P. A. 77-669 of the Income Tax Act:

"**§ 102. Construction.** Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 and other provisions of the statutes of the United States relating to federal income taxes as such Code and statutes are in effect on the date of enactment of this Act."

§ 201. Tax imposed.—(a) *In general.* A tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 on the privilege of earning or receiving income in or as a resident of this State. Such tax shall be in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

(b) *Rates.* The tax imposed by this section shall be—

(1) In the case of an individual, trust or estate, an amount equal to 2½% of the taxpayer's net income for the taxable year;

(2) In the case of a corporation, an amount equal to 4% of the taxpayer's net income for the taxable year.

"**§ 202. Net Income Defined (a) In general.** For purposes of this Act, a taxpayer's net income for a taxable year shall be that portion of his base income for such year which is allocable to this State under the provisions of Article 3, less the standard exemption allowed by section 204.

"**(b) Taxable years beginning before August 1, 1969.** (1) Net income for a taxable year which begins before August 1, 1969 and ends after July 31, 1969 shall be that amount which bears the same ratio to the tax-

payer's net income for the entire taxable year as the number of days in such year after July 31, 1969 bears to the total number of days in such year, unless the taxpayer elects to apportion net income for such taxable year in the manner provided by paragraph (2).

(2) If the taxpayer so elects, in the case of a taxable year beginning before August 1, 1969 and ending after July 31, 1969, there shall be taken into account in computing base income only those items earned, received, paid, incurred or accrued after July 31, 1969, and the standard exemption provided by section 204 shall be limited to that amount which bears the same ratio to the total exemption allowable under such section (determined without regard to this section) as the number of days after July 31, 1969 in the taxable year bears to 365. The election provided by this paragraph shall be made in such manner and at such time as the Department may by forms or regulations prescribe, but shall be made not later than the due date (including any extensions thereof) for the filing of the return for the taxable year, and shall be irrevocable."

"**§ 203. Base Income Defined. (a) Individuals. (1) In general.** In the case of an individual, base income means an amount equal to the taxpayer's adjusted gross income for the taxable year as modified by paragraph (2).

(2) Modifications. The adjusted gross income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest or dividends during the taxable year to the extent excluded from gross income in the computation of adjusted gross income;

(B) An amount equal to 50% of the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, to the extent deducted from gross income in the computation of adjusted gross income; and

(C) An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of adjusted gross income for the taxable year,

and by deducting from the total so obtained an amount equal to the sum of all amounts included therein which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States."

"**(b) Corporation. (1) In general.** In the case of a corporation, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).

(2) Modifications. The taxable income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest during the taxable year to the extent excluded from gross income in the computation of taxable income;

(B) An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of taxable income for the taxable year;

(C) In the case of a regulated investment company or real estate investment trust, an amount equal to the excess of (i) the net long-term capital gain for the taxable year, over (ii) the amount of the capital gain dividends attributable to the taxable year; and

(D) In the case of a Western Hemisphere trade corporation, China Trade Act corporation, or possessions company described in section 931(a) of the Internal Revenue Code, an amount equal to the amount deducted or excluded from gross income in the computation of taxable income for the taxable year on account of the special deductions and exclusions (but in the case of a possessions company, net of the deductions allocable thereto)

allowed such corporations under the Internal Revenue Code,

and by deducting from the total so obtained an amount equal to the sum of all amounts included therein which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States.

(3) Special rule. For purposes of paragraph (2) (A), "gross income" in the case of a life insurance company shall mean the company's share of the gross investment income for the taxable year."

"**(c) Trusts and estates. (1) In general.** In the case of a trust or estate, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).

(2) Modifications. Subject to the provisions of paragraph (3), the taxable income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest or dividends during the taxable year to the extent excluded from gross income in the computation of taxable income;

(B) An amount equal to 50% of the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, to the extent deducted from gross income in the computation of taxable income;

(C) In the case of (i) an estate, $600; (ii) a trust which, under its governing instrument, is required to distribute all of its income currently, $300; and (iii) any other trust, $100, but in each such case, only to the extent such amount was deducted in the computation of taxable income; and

(D) An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of taxable income for the taxable year,

and by deducting from the total so obtained an amount equal to the sum of all amounts included therein which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States.

(3) Limitation. The amount of the modification determined under paragraph (2) (A) and (B) shall be reduced by any amounts included therein which were properly paid, credited, or required to be distributed for the taxable year."

"**(d) Gross income; adjusted gross income; taxable income. (1) In general.** Subject to the provisions of paragraph (2) and subsection (b) (3), for purposes of this section a taxpayer's gross income, adjusted gross income, or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code.

(2) Special rule. For purposes of paragraph (1) of this subsection, the taxable income properly reportable for federal income tax purposes shall mean:

(A) Certain life insurance companies. In the case of a life insurance company subject to the tax imposed by section 802 of the Internal Revenue Code, life insurance company taxable income;

(B) Certain mutual insurance companies. In the case of a mutual insurance company subject to the tax imposed by section 821(a) or (c) of the Internal Revenue Code, mutual insurance company taxable income or taxable investment income, as the case may be;

(C) Regulated investment companies. In the case of a regulated investment company subject to the tax imposed by section 852 of the Internal Revenue Code, investment company taxable income;

(D) Real estate investment trusts. In the case of a real estate investment trust subject to the tax

imposed by section 857 of the Internal Revenue Code, real estate investment trust taxable income;

(E) Consolidated corporations. In the case of a corporation which is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes, taxable income determined as if such corporation had filed a separate return for federal income tax purposes for the taxable year and each preceding taxable year for which it was a member of an affiliated group. For purposes of this subparagraph, the taxpayer's separate taxable income shall be determined as if the election provided by section 243(b) (2) of the Internal Revenue Code had been in effect for all such years; and

(F) Cooperatives. In the case of a cooperative corporation or association, the taxable income of such organization determined in accordance with the provisions of sections 1381 through 1388 of the Internal Revenue Code."

Amended § 203. **Base Income Defined.**

(a) Individuals.

(1) In general. In the case of an individual, base income means an amount equal to the taxpayer's adjusted gross income for the taxable year as modified by paragraph (2).

(2) Modifications. The adjusted gross income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest or dividends during the taxable year to the extent excluded from gross income in the computation of adjusted gross income;

(B) An amount equal to 50% of the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, to the

extent deducted from gross income in the computation of adjusted gross income; and

(C) An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of adjusted gross income for the taxable year, and by deducting from the total so obtained the sum of the following amounts;

(D) Any amount included in such total in respect of any compensation paid to a resident in 1970 or thereafter by reason of being on active duty in the Armed Forces of the United States;

(E) An amount equal to all amounts included in such total pursuant to the provisions of sections 402(a), 402(c), 402(d), 403(a), 403(b), 405(d), 406(a) and 407(a) of the Internal Revenue Code, but only to the extent such amount is determined, under regulations prescribed by the Department, to be attributable to benefits accrued (whether or not vested) during plan years beginning before August 1, 1969 by or on behalf of the employee with respect to whom such amounts are received;

(F) The valuation limitation amount; and

(G) An amount equal to all amounts included in such total which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States.

(b) Corporations.

(1) In general. In the case of a corporation, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).

(2) Modifications. The taxable income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest during the taxable year to the extent excluded from gross income in the computation of taxable income;

(B) An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of taxable income for the taxable year;

(C) In the case of a regulated investment company or real estate investment trust, an amount equal to the excess of (i) the net long-term capital gain for the taxable year, over (ii) the amount of the capital gain dividends attributable to the taxable year; and

(D) In the case of a Western Hemisphere trade corporation, China Trade Act corporation, or possessions company described in section 931(a) of the Internal Revenue Code, an amount equal to the amount deducted or excluded from gross income in the computation of taxable income for the taxable year on account of the special declarations and exclusions (but in the case of a possessions company, net of the deductions allocable thereto) allowed such corporations under the Internal Revenue Code,

and by deducting from the total so obtained an amount equal to the sum of all amounts included therein which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States.

(3) Special rule. For purposes of paragraph (2) (A), "gross income" in the case of a life insurance company shall mean the company's share of the gross investment income for the taxable year.

(e) Trusts and estates.

(1) In general. In the case of a trust or estate, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).

(2) Modifications. Subject to the provisions of paragraph (3), the taxable income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest or dividends during the taxable year to the extent excluded from gross income in the computation of taxable income;

(B) An amount equal to 50% of the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, to the extent deducted from gross income in the computation of taxable income;

(C) In the case of (i) an estate, $600; (ii) a trust which, under its governing instrument, is required to distribute all of its income currently, $300; and (iii) any other trust, $100, but in each such case, only to the extent such amount was deducted in the computation of taxable income; and

(D) An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of taxable income for the taxable year,

and by deducting from the total so obtained an amount equal to the sum of the following amounts:

(E) An amount equal to all amounts included in such total pursuant to the provisions of sections 402(a), 402(c), 402(d), 403(a), 403(b), 405(d), 406(a) and 407(a) of the Internal Revenue Code, but only to the extent such amount is determined, under regulations prescribed by the Department, to be attributable to benefits accrued (whether or not vested) during plan years beginning before August 1, 1969 by or on behalf of the employee with respect to whom such amounts are received;

(F) The valuation limitation amount; and

(G) An amount equal to all amounts included in such total which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States.

(3) Limitation. The amount of any modification otherwise required under this subsection shall, under regulations

prescribed by the Department, be adjusted by any amounts included therein which were properly paid, credited, or required to be distributed for the taxable year.

(d) Gross income; adjusted gross income; taxable income.

(1) In general. Subject to the provisions of paragraph (2) and subsection (b) (3), for purposes of this section a taxpayer's gross income, adjusted gross income, or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code.

(2) Special rule. For purposes of paragraph (1) of this subsection, the taxable income properly reportable for federal income tax purposes shall mean:

(A) **Certain life insurance companies.** In the case of a life insurance company subject to the tax imposed by Section 802 of the Internal Revenue Code, life insurance company taxable income;

(B) **Certain mutual insurance companies.** In the case of a mutual insurance company subject to the tax imposed by Section 821(a) or (c) of the Internal Revenue Code, mutual insurance company taxable income or taxable investment income, as the case may be;

(C) **Regulated investment companies.** In the case of a regulated investment company subject to the tax imposed by Section 852 of the Internal Revenue Code, investment company taxable income;

(D) **Real estate investment trusts.** In the case of a real estate investment trust subject to the tax imposed by Section 857 of the Internal Revenue Code, real estate investment trust taxable income;

(E) **Consolidated corporations.** In the case of a corporation which is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes,

taxable income determined as if such corporation had filed a separate return for federal income tax purposes for the taxable year and each preceding taxable year for which it was a member of an affiliated group. For purposes of this subparagraph, the taxpayer's separate taxable income shall be determined as if the election provided by Section 243(b) (2) of the Internal Revenue Code had been in effect for all such years; and

(F) **Cooperatives.** In the case of a cooperative corporation or association, the taxable income of such organization determined in accordance with the provisions of Sections 1381 through 1388 of the Internal Revenue Code.

(e) Valuation limitation amount.

(1) In general. The valuation limitation amount referred to in subsections (a) (2) (F) and (c) (2) (F) is an amount equal to:

(A) The sum of the pre-August 1, 1969 appreciation amounts (to the extent consisting of gain reportable under the provisions of section 1245 or 1250 of the Internal Revenue Code) for all property in respect of which such gain was reported for the taxable year; plus

(B) The lesser of (i) the sum of the pre-August 1, 1969 appreciation amounts (to the extent consisting of capital gain) for all property in respect of which such gain was reported for federal income tax purposes for the taxable year, or (ii) the net capital gain for the taxable year, reduced in either case by any amount of such gain included in the amount determined under subsection (a) (2) (E) or (c) (2) (E).

(3) Pre-August 1, 1969 appreciation amount.

(A) If the fair market value of property referred to in paragraph (2) (A) was readily ascertainable on August 1, 1969, the pre-August 1, 1969 appreciation amount for such property is the lesser of (i) the excess of such fair market value over the taxpayer's basis (for determining gain) for such property on that date (determined under the Internal Revenue Code as in

effect on that date), or (ii) the total gain realized and reportable for federal income tax purposes in respect of the sale, exchange or other disposition of such property.

(B) If the fair market value of property referred to in paragraph (2) (A) was not readily ascertainable on August 1, 1969, the pre-August 1, 1969 appreciation amount for such property is that amount which bears the same ratio to the total gain reported in respect of the property for federal income tax purposes for the taxable year, as the number of full calendar months in that part of the taxpayer's holding period for the property ending July 31, 1969 bears to the number of full calendar months in the taxpayer's entire-holding period for the property.

(C) The Department shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph.

(f) Double deductions. Nothing in this section shall permit the same item to be deducted more than once.

(4) Legislative intention. Except as expressly provided by this section, there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise. Amended by P. A. 76-2029, § 1, eff. July 1, 1970; P. A. 77-669, § 1, eff. Aug. 9, 1971.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972.

No. 72-283

GEORGE E. MAHIN, AS DIRECTOR OF REVENUE OF THE STATE OF ILLINOIS,

Petitioner,

vs.

TERRANCE R. MITCHELL, ASALEE LABORN, ERNEST J. NASSOS, JOHN A. PETERSON AND FREDERICK W. WENDNAGEL,

Respondents.

SUPPLEMENTAL BRIEF FILED PURSUANT TO RULE 24(5) IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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IN THE

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SUPPLEMENTAL BRIEF FILED PURSUANT TO RULE 24(5) IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

George E. Mahin, as Director of Revenue of the State of Illinois (petitioner) respectfully files this supplemental brief to his petition for writ of certiorari for the purpose of calling to this Court's attention certain new matter, pursuant to Rule 24(5).

The Connecticut Cases.

Since petitioner's petition was prepared, two extremely important decisions of the Connecticut Supreme Court have been published, both of which add substantial support to petitioner's contention that the holding of the Illinois Supreme Court in this case is utterly lacking in fair or sub-

stantial support, and was based upon a misapprehension of the applicable federal constitutional law.

Kellems v. *Brown, Tax Commissioner* and *Peterson* v. *Sullivan, Tax Commissioner* do not yet appear in the official Connecticut Reports nor in the Atlantic Second Reports, but they do appear in 34 Connecticut Law Journal No. 6. For the convenience of the Court, these opinions are printed in full in the Appendix to this supplemental brief. At least one of these cases (*Kellems*) will be appealed to this Court.

Kellems v. *Brown* presented numerous questions concerning the Connecticut Capital Gains and Dividends Tax, enacted in the June, 1971, special session of the Connecticut General Assembly. Only one of these is of importance here. Section 12-506 of that Act imposes a tax at the rate of 6% on all "gains from the sale or exchange of capital assets occurring after December 31, 1970, which have been earned, received in fact or constructively, accrued or credited to the taxpayer during his taxable year." Further, section 55-3 of the Connecticut General Statutes provides:

> No provision of the general statutes, not previously contained in the statutes of the state, which imposes any new obligation on any person or corporation, shall be construed to have a retrospective effect.

Like the Illinois Income Tax Act, the Connecticut statute defines terms by specific reference to the federal tax law but contains no express provision requiring the use of federal basis for determining gain or loss.

The taxpayers in the *Kellems* case made three arguments, as stated by the Connecticut Supreme Court:

> • • • First, they maintain that § 12-506 of the General Statutes should, as a matter of statutory construction, be interpreted not to adopt the federal basis for the taxation of capital gains but to tax, when realized, only accretions in value after December 31, 1970. Second, they argue that § 55-3 of the General Statutes requires that § 12-506 be construed to allow the taxpayer to use instead of the federal basis for computing capital gains

the fair market value of the asset on December 31, 1970. Finally, they contend that if the statute is construed as adopting the federal basis for the computation of capital gain that such a construction would render the statute impermissibly retroactive under the United States and Connecticut constitutions (34 Conn. L. J. No. 6, pp. 9-10)

Although the taxpayers' arguments with respect to construction are those which the Illinois court adopted in this case, the Connecticut Supreme Court had no difficulty in rejecting them as non-meritorious, pointing out:

• • • "When two constructions are possible, courts will adopt the one which makes the statute effective and workable, and not the one which leads to difficult and possibly bizarre results." • • •

From a close examination of the entire act, it is obvious that the legislature intended to incorporate and adopt the federal basis for computation of capital gains and loss. Section 12-505 specifically states: "Gains from the sale or exchange of capital assets means net gains as defined for federal income tax purposes." While there is some ambiguity in the meaning of "net gains" (a problem which we will discuss later in this opinion), we believe that **the reference to the federal income tax structure is of controlling significance and decisive on the question of what basis is to be used in computing the tax on gains from the sale or exchange of capital assets.**

• • • • •

We find no indication either in the language of the act itself or in its legislative history that the General Assembly intended to adopt any other standard for taxing capital gain than that employed for federal tax purposes to which standard the act makes specific reference. Only gains realized after December 31, 1970, are taxed under the act. **The fact that the amount of tax depends, among other things, on the cost of the asset which may have been acquired prior to the enactment of the tax does not make the tax retrospective. The tax being imposed at the time of realization of the gain operates only in a prospective manner and, accord-**

ingly, does not operate counter to the proscription of § 55-3 of the General Statutes. (34 Conn. L. J. No. 6, pp. 10-11; emphasis supplied)

This language of the Connecticut Supreme Court is virtually identical with that in the dissenting opinion of Justices Davis and Schaefer in the instant case:

> * * * Section 102 of the Act states: "Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 * * *." (Ill. Rev. Stat. 1971, ch. 120, par. 1-102.) Section 201(a) states that the tax imposed is to be measured by "net income". Section 202 thereafter defines "net income": "* * * a taxpayer's net income for a taxable year shall be that portion of his base income for such year which is allocable to this State * * *." Section 203 then defines "base income" to mean "adjusted gross income for the taxable year" in the case of individuals, and "taxable income for the taxable year" in the cases of corporations, trusts and estates. Section 203(d)(1) then provides that: "* * * a taxpayer's gross income, adjusted gross income, or taxable income for a taxable year shall mean the amount of gross income, adjusted gross income or taxable income **properly reportable for federal income tax purposes** for the taxable year under the provisions of the Internal Revenue Code.
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> * * * * *
>
> *** * * It seems apparent that the taxpayer's base income was meant to be his adjusted gross or taxable income for Federal taxation purposes except as specifically modified in section 203 of our Act. This section did not contain the specific modification imposing the August 1, 1969 valuation limitation date read into the Act by the court in Thorpe.** (51 Ill. 2d at 465-466; 283 N. E. 2d at 472; emphasis supplied)

Contrast the Connecticut court's opinion with the reasoning in *Thorpe:*

• • • For the reasons hereafter given, we consider the legislative intent to be that, in the computation of capital gains and losses, the value of property acquired prior to August 1, 1969, shall, for the purpose of computation of gains or losses be limited by its value determined as of August 1, 1969.

First, we have the familiar rule that statutes will not be construed *retroactively* unless it clearly appears such was the legislative intention. • • • The Act is clear, indeed it expressly provides, that the tax shall operate prospectively beginning August 1, 1969. The Act does not state, however, whether the basis for determining gain or loss from the sale or exchange of a capital asset purchased or acquired prior to August 1, 1969, should be its August 1, 1969, value or its date of acquisition value. The terms of the Code are, of course, incorporated by reference; but **it is most unusual that the tax would be made prospective by such specific language and the basis date for computing gain on the sale or exchange of property should be made retroactive by such nonspecific language**, particularly when the rule of statutory construction is that statutes will not be construed retroactively unless it clearly appears such was the legislative intent.

Second, we have the equally familiar rule that "It is our duty so to interpret the statute as to promote its essential purposes and to avoid, if possible, a construction that would raise doubts as to its validity." • • • **It is questionable that the General Assembly, by the nonspecific language which it employed, intended to adopt the basis dates from the Internal Revenue Code when such dates under our newly enacted Income Tax Act would raise doubts as to its validity.** (43 Ill. 2d at 50-52, 250 N. E. 2d at 640-641; emphasis supplied)

Where the Connecticut court found "specific reference" to "the federal income tax structure" to be "of controlling significance and decisive on the question of what basis is to be used in the computing the tax on gains from the sale or exchange of capital assets," the Illinois court found in-

corporation by reference of the terms of the Internal Revenue Code to be "nonspecific language" insufficient to incorporate the federal basis rules. As stated by Justice Davis in his dissenting opinion:

> • • • The finding in *Thorpe* that the legislature intended an August 1, 1969, valuation date for the computation of capital gains and losses can have **no basis other than the misapprehension that without such a finding the tax would have been retroactive and, perhaps, unconstitutional.** (51 Ill. 2d at 459; 283 N. E. 2d at 468; emphasis supplied)

The *Thorpe* court's misconception as to "retroactivity" lies at the heart of its decision as to legislative intent. This question was *not* presented to the court in *Thorpe,* and the refusal of the Illinois Supreme Court in the instant case to consider it constitutes a critical failure to come to grips with the fundamental constitutional question. On this issue, the Connecticut court, like the courts of many other states which have been willing to face it, concluded that:

> A tax on realized capital gain does not operate in a retroactive manner merely because ascertainment of the amount of the gain is measured by the difference between the sale price received during the tax year and the taxpayer's basis which may have been established at some earlier time. (34 Conn. L. J. No. 6, p. 11)

The Connecticut court noted that the *Thorpe* case "appears to have reached a contrary conclusion," but chose not to emphasize its disagreement with the Illinois court, saying merely that that decision "was based primarily on the court's interpretation of the Illinois statute • • • which expressly provided that the tax should operate prospectively beginning August 1, 1969." Actually, the holding in the *Kellems* case is in direct conflict with *Thorpe* and with the instant case, since the Connecticut statute (§ 55-3) also expressly requires that the new capital gains tax operate prospectively only.

Petitioner has been advised by counsel for the plaintiff in the *Kellems* case that an appeal to this Court will be taken under 28 U. S. C. § 1257(2). This Court will, therefore, have an opportunity to rule definitively upon the constitutionality of taxation of gains accrued but not realized prior to enactment of a state income tax statute. Petitioner believes that this Court will find such taxation constitutional. Assuming that this proves to be the case, to permit the decision of the Illinois Supreme Court to stand without review would be to deprive the State of Illinois of vitally needed revenue by virtue of a decision rooted in a misconception of applicable constitutional principles. There is no fair or substantial support for the stated nonfederal ground of decision in this case; the decision was impelled either by the Illinois Supreme Court's erroneous belief that the United States Constitution requires an effective date valuation limitation, or by its attempt to evade consideration of this federal constitutional issue. In either event, this Court has jurisdiction to review and reverse, or, at the least, remand this case.

The Missouri Statute.

Act 175, enacted by the 76th General Assembly of Missouri and approved on June 23, 1972, with an effective date of January 1, 1973, appears in Vernon's Missouri Legislative Service No. 3. This Act enacts an entirely new Missouri income tax tied to the federal statutes, and repeals the previous "start-from-scratch" Missouri tax. Section 143.091 of the new Act provides that "Any term used in this act shall have the same meaning as when used in a comparable context in the laws of the United States relating to income taxes, unless a different meaning is clearly required by the provisions of this act," but, like the Illinois Income Tax Act, it contains no express reference to the use of federal basis for determining gain or loss. Also like the

Illinois Income Tax Act and the Connecticut Capital Gains and Dividends Tax Act, the new Missouri statute contains no express effective date valuation limitation. The only adjustment provided for appears in section 143.121 which provides that in determining Missouri adjusted gross income, there shall be deducted from federal adjusted gross income:

> The portion of any gain, from the sale or other disposition of property having a higher adjusted basis to the taxpayer for Missouri income tax purposes than for federal income tax purposes on December 31, 1972, that does not exceed such difference in basis. If a gain is considered a long-term capital gain for federal income tax purposes, the modification shall be limited to one-half of such portion of the gain.

Inasmuch as the only property which could have a higher adjusted basis for Missouri income tax purposes than for federal income tax purposes would be property acquired before January 1, 1917, as to which section 143.190 of the present Missouri income tax act provides a special basis, it is clear that the new Missouri income tax contains no prohibition against the taxation of gains accruing prior to its enactment. The holding of the Illinois Supreme Court in the instant case, as in *Thorpe,* flies in the face of the legislative history of the Illinois statute, the wording of the statute itself, which corresponds with that of Connecticut and Missouri as well as many other states, and numerous decisions of this Court and of the highest state courts. It is

without support; it introduces an element of unwarranted confusion into an area of law where uniformity is of the utmost desirability; it should be reviewed and reversed.

Respectfully submitted,

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APPENDIX.

SUPREME COURT
June Term, 1972

VIVIEN KELLEMS ET AL. v. F. GEORGE BROWN, TAX COMMISSIONER, ET AL.

Action for a declaratory judgment concerning the construction and the constitutionality of a statute imposing a tax on dividends and capital gains, brought to the Superior Court in Hartford County and reserved by the court, *Rubinow, J.*, for the advice of this court.

John S. Murtha, with whom were *John E. Silliman* and *Willard F. Pinney, Jr.*, and, on the brief, *J. Read Murphy*, for the plaintiffs.

Ralph G. Murphy, assistant attorney general, with whom were *John M. Dunham* and *Richard K. Greenberg*, assistant attorneys general, and, on the brief, *Robert K. Killian*, attorney general, for the defendants.

HOUSE, C. J. This case started out as an action for a declaratory judgment and for ancillary relief by way of an injunction. The action was obviously designed primarily to seek a determination of the constitutionality of chapter 224 of the General Statutes, commonly known as the Capital Gains and Dividends Tax. This chapter was enacted as Public Act No. 8 of the June, 1971, special session of the General Assembly. The procedure finally followed by the parties, however, deviated from the usual practice of a direct stipulation as to the operative facts with a prayer for relief stating "with precision the declaratory judgment

desired." Practice Book § 310(b). Instead, following the practice customarily followed in will construction suits, the parties stipulated for a reservation of the case to this court on an agreed statement of facts, propounding twenty questions on which the advice of the court was sought. See Practice Book §§ 738, 739, Form 614, p. 759. Two questions (Nos. 2 and 4) were not pursued in this court and one (No. 5) has become moot. The remaining questions are set out in the footnote.[1]

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1. "1. Do the provisions of Chapter 224 imposing a tax on dividends received by individual residents of the State of Connecticut and leaving untaxed other items of unearned income received by said individuals violate the equal protection provisions of (a) Article First, Section 20 of the Connecticut Constitution? (b) Section 1 of the 14th Amendment to the United States Constitution (hereinafter 14th Amendment)?

• • • • •

"3. Do the provisions of Section 12-506(c)(3) which grant an exemption to any person who is unmarried and a widow on the last day of her taxable year, which is two and one-half times greater than the same exemption granted to a person who is not such a widow, violate the equal protection provisions of (a) Article First, Section 1 of the Connecticut Constitution? (b) Article First, Section 20 of the Connecticut Constitution? (c) Section 1 of the 14th Amendment?

• • • • •

"6. Are any of the Sections of Chapter 224 void for vagueness under the due process clause of (a) Article First, Section 8 of the Connecticut Constitution? (b) Section 1 of the 14th Amendment?

"7. As to each of the following sections of the Chapter is there an unlawful delegation of legislative power to an administrative official in violation of Article First, Section 8, Article Second and Article Third, Section 1 of the Connecticut Constitution (a) Section 12-508? (b) Section 12-510? (c) Section 12-516? (d) Section 12-517? (e) Section 12-518?

"8. As to each of the following sections of the Chapter is there an unlawful delegation of legislative power from the Connecticut General Assembly to the Congress of the United States in violation of any of Article First, Section 8, Article Second and Article Third, Section 1 of the Connecticut Constitution (a) Section 12-505? (b) Section 12-506? (c) Section 12-506a?

"9. As to each of following sections of the Chapter is there an unlawful delegation of legislative power from the Connecticut

Perhaps because of this unorthodox procedure many of the questions reserved for the advice of this court lack the precision and specificity which is not only desirable but

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General Assembly to the Congress of the United States in violation of the 10th Amendment to the United States Constitution (a) Section 12-505? (b) Section 12-506? (c) Section 12-506a?

"10. Does Section 12-505 of the Chapter define 'net gains' in such a manner as to interfere retroactively and unlawfully with vested rights in violation of the due process provisions of (a) Article First, Section 8 of the Connecticut Constitution? (b) Section 1 of the 14th Amendment?

"11. Do Sections 12-521 and 12-522, read in conjunction with Section 12-515, provide an adequate procedural relief in compliance with the due process provisions of (a) Article First, Section 8 of the Connecticut Constitution? (b) Section 1 of said 14th Amendment?

"12. Is the plaintiff Kellems obligated by law to pay the tax imposed by Chapter 224 upon dividends as defined by Section 12-505 which she has received during calendar year 1971?

"13. Is the plaintiff Miller obligated by law to pay the tax imposed by Chapter 224 upon dividends, as defined by Section 12-505, which dividends he has received during calendar year 1971?

"14. Is the plaintiff Marsh obligated by law to pay the tax imposed by Chapter 224 upon his gains from the sale of capital assets as defined by Section 12-505, which gains he has realized during calendar year 1971?

"15. If the answer to the preceding question is 'Yes,' is the plaintiff Marsh entitled to compute such gains within the meaning of Sections 12-505 and 12-506 using as his basis the value of his securities (a) on December 31, 1970? (b) on August 15, 1971?

"16. If neither of the dates in question 15 is applicable, must the plaintiff Marsh compute such gains within the meaning of Sections 12-505 and 12-506 using as his basis the value of his securities on the date of his acquisition, February 28, 1968?

"17. If the answer to question 14 is 'Yes,' must the plaintiff Marsh compute such tax at 6% of 100% of his net capital gains realized by him during calendar year 1971?

"18. If the answer to question 17 is 'No,' does the plaintiff Marsh compute such tax at 6% of 50% of such net capital gains?

"19. Is the plaintiff Marsh entitled to an exemption under the provisions of Section 12-506(c)(1) which is more than $2000?

"20. If the answer to question 13 is 'Yes,' may the plaintiff Miller deduct from his dividend income his capital losses realized in 1971?"

also mandatory in a declaratory judgment action. Practice Book § 310(b). See *Plunkett* v. *Nationwide Mutual Ins. Co.*, 150 Conn. 203, 211, 187 A. 2d 754; *Holt* v. *Wissinger*, 145 Conn. 106, 109, 139 A. 2d 353; *Kievman* v. *Grevers*, 122 Conn. 406, 412, 189 A. 609. More particularly, many of the questions reserved are not limited to the situation of the particular plaintiffs as disclosed in the stipulation of facts or to the impact of the statutory provisions on any right of these plaintiffs as distinguished from the rights of any person not a party to this action. "[A] plaintiff, in challenging the constitutionality of a statute, must sustain the burden of proving that the effect or impact of the challenged statute on him adversely affects a constitutionally protected right which he has. 'This means a right which he proves that he has under the facts of his particular case and not merely under some possible or hypothetical set of facts not proven to exist.' *Hardware Mutual Casualty Co.* v. *Premo*, . . .[153 Conn. 465, 471, 217 A. 2d 698]." *Adams* v. *Rubinow*, 157 Conn. 150, 152, 251 A. 2d 49; *Riley* v. *Liquor Control Commission*, 153 Conn. 242, 215 A. 2d 402; *Karen* v. *East Haddam*, 146 Conn. 720, 727, 155 A. 2d 921. A number of the plaintiffs' questions are not susceptible of the dogmatic and categorical answers which the plaintiffs seek. Under the circumstances, it is only because of the importance of the issues involved and the great public interest in them that we undertake, so far as is reasonably possible, to include in our discussion answers to some of the broad questions propounded. We do so with the express caveat that such answers are applicable only within the limited context of the specific facts covered by the stipulation agreed on by the parties to this action.

Chapter 224, to which we will hereafter refer as the act, is too long to be incorporated in this opinion and may be found in the 1971 Public Acts and General Statutes §§ 12-505—12-522. In essence, the act levies an income tax

on dividends received and capital gains realized by residents of Connecticut.[2] It is unnecessary to summarize in any detail the facts as stipulated by the parties. It suffices to note that the defendant F. George Brown is the state tax commissioner, that the plaintiffs Vivien Kellems, Carl E. Miller and Bryan H. Marsh are all residents of Connecticut, that during 1971 Kellems and Miller received dividends as that term is defined in the federal Internal Revenue Code, and that during 1971 Marsh received net gains from the sale or exchange of capital assets as those terms are defined in chapter 224.

As briefed by the parties, the case reserved for the advice of this court involves five principal issues, four of them involving the constitutionality of the act and the fifth primarily questions of statutory construction. The plaintiffs claim that (1) chapter 224 violates the equal protection provisions of the state and federal constitutions in singling out for taxation dividends received by individuals while not taxing interest income and other types of investment income; that (2) the act is so badly drafted as to be void for vagueness under the due process clauses of the state and federal constitutions; that (3) the act unlawfully delegates legislative powers to the state tax commissioner and the federal government in violation of applicable constitutional principles; that (4) if the basis for measuring capital gains is not limited to the increase in value subsequent to December 31, 1970, then the capital gains tax violates the due process provisions of the state and federal constitutions; and that (5) even if the act is otherwise valid, a proper construction of its provisions requires that the taxpayer be permitted a deduction of 50 percent of his net long term capital gains less net short term capital losses.

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2. For a general discussion of the 1971 act, see Lester B. Snyder, "Tax Policy in the 1971 Connecticut General Assembly," 46 Conn. B. J. 136 (1972) and Frank S. Berall, "Connecticut's Investment Income Tax," id., p. 185.

I.

(a) We consider first the contention of the plaintiffs that the act is unconstitutional because it establishes arbitrary and unreasonable classifications in the designation of the subject of the tax and in the added exemption allowed to "any person who is unmarried and a widow on the last day of her taxable year." § 12-506(c)(3). It is the plaintiffs' claim that the classifications designated by the act violate the equal protection clauses of the fourteenth amendment to the constitution of the United States, § 1, and the constitution of Connecticut, article first, § 20. The Connecticut constitutional provision has "a like meaning to that in the fourteenth amendment to the constitution of the United States which prohibits the states from denying to any person the equal protection of the laws." *Lyman* v. *Adorno*, 133 Conn. 511, 515, 52 A. 2d 702; *State ex rel. Brush* v. *Sixth Taxing District*, 104 Conn. 192, 195, 132 A. 561. The plaintiffs assert that these constitutional provisions are violated by the imposition of the tax on investment income derived from dividends and capital gains while investment income in the form of interest and rents is not subject to the tax. Similarly, they contest the constitutional validity of the provision of the act which grants to "any person who is unmarried and a widow" a tax exemption which is two and one-half times greater than the exemption granted to other taxpayers including widowers, divorced women and women who have never married.

It is well settled that a plaintiff who attacks a statute on constitutional grounds has no easy burden. As this court said in *Adams* v. *Rubinow*, 157 Conn. 150, 152-53, 251 A. 2d 49: "Because of the separation of powers, one claiming that a legislative enactment is invalid on the ground that it is unconstitutional must establish its invalidity on that ground beyond a reasonable doubt. *Hardware Mutual Casualty Co.* v. *Premo*, 153 Conn. 465, 470, 217 A. 2d 698.

. . . [W]here a statute reasonably admits of two constructions, one valid and the other invalid on the ground of unconstitutionality, courts should adopt the construction which will uphold the statute even though that construction may not be the obvious one. *Carilli* v. *Pension Commission*, 154 Conn. 1, 8, 220 A. 2d 439; *Ferguson* v. *Stamford*, 60 Conn. 432, 447, 22 A. 782; *Wilton* v. *Weston*, 48 Conn. 325, 338. Of course, the fact that the plaintiffs chose to request a declaratory judgment, upon a stipulation of facts, in nowise changes or relieves them of the burden of proof resting on them. *Hardware Mutual Casualty Co.* v. *Premo*, *supra*, 472, 473." To like effect we said in *Edwards* v. *Hartford*, 145 Conn. 141, 145, 139 A. 2d 599: "Courts in passing upon the validity of a legislative act do not feel justified in declaring it void unless there is a clear and unequivocal breach of the constitution. . . . We approach the question with great caution, examine it with infinite care, make every presumption and intendment in favor of validity, and sustain the act unless its invalidity is, in our judgment, beyond a reasonable doubt."

In Connecticut, the power to levy taxes is vested in the General Assembly. *Beach* v. *Bradstreet*, 85 Conn. 344, 348, 82 A. 1030. Unlike the federal constitutional limitation which existed prior to adoption of the sixteenth amendment, it appears that this state's power of taxation has never been constitutionally limited except by the constitutional requirements of equal protection and due process. See *Montgomery* v. *Branford*, 107 Conn. 697, 707-8, 142 A. 574. In selecting the subjects of taxation, legislatures have been allowed broad discretion. "The latitude of discretion is notably wide in the classification of property for the purposes of taxation and granting of partial or total exemptions upon grounds of policy." *Royster Guano Co.* v. *Virginia*, 253 U. S. 412, 415, 40 S. Ct. 560, 64 L. Ed. 989. As the United States Supreme Court observed in *Madden* v. *Kentucky*, 309 U. S. 83, 87-88, 60 S. Ct. 406, 84 L. Ed.

590: "The broad discretion as to classification possessed by a legislature in the field of taxation has long been recognized. This Court fifty years ago concluded that 'the Fourteenth Amendment was not intended to compel the State to adopt an iron rule of equal taxation,' and the passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. Traditionally classification has been a device for fitting tax programs to local needs and usages in order to achieve an equitable distribution of the tax burden. It has, because of this, been pointed out that in taxation, even more than in other fields, legislatures possess the greatest freedom in classification. Since the members of a legislature necessarily enjoy a familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it."

In *State* v. *Murphy*, 90 Conn. 662, 666, 98 A. 343, this court similarly stated: "The taxing power is an inherent attribute of sovereignty and as such unlimited in character and scope save as limitations may be self-imposed. Under our form of government its exercise is vested in the legislative department which may exercise it for lawful purposes in its discretion both as regards the choice of the subject-matter of taxation and the extent and manner of the tax, save as constitutional limitations may intervene, and in the case of the States save also as the property and agencies of the national government within their borders are not within the reach of their sovereignty. *M'Culloch* v. *Maryland*, 17 U. S. (4 Wheat.) 316, 428; *Nathan* v. *Louisiana*, 49 U. S. (8 How.) 73, 82; *Ward* v. *Maryland*, 79 U. S. (12 Wall.) 418, 426; *North Missouri R. Co.* v. *Maguire*, 87 U. S.

(20 Wall.) 46, 62. In the choice of subject-matter there is no restriction, not constitutional, short of one imposed by lack of jurisdiction. 'Whether it be person or property, or possession, franchise or privilege, or occupation or right,' the legislative power extends to it. 'It reaches to every trade or occupation; to every object of industry, use or enjoyment,' in fact to every subject over which the sovereignty of the State extends, and is co-extensive with that sovereignty. 1 Cooley on Taxation (3d Ed.) 9; Cooley's Constitutional Limitations (7th Ed.) 678; *M'Culloch* v. *Maryland*, 17 U. S. (4 Wheat.) 316, 429; *Providence Bank* v. *Billings*, 29 U. S. (4 Pet.) 514, 563; *Ward* v. *Maryland*, 79 U. S. (12 Wall.) 418, 426; *North Missouri R. Co.* v. *Maguire*, 87 U. S. (20 Wall.) 46, 62."

More recently, in *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U. S. 522, 526, 527, 79 S. Ct. 437, 3 L. Ed. 2d 480, the United States Supreme Court thus stated the guiding principles: "Of course, the States, in the exercise of their taxing power, are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment. But that clause imposes no iron clad rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation. . . . 'To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure. *Ohio Oil Co.* v. *Conway*, . . .[281 U. S. 146, 159, 50 S. Ct. 310, 74 L. Ed. 775] . . . . 'If the selection or classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the law. *Brown-Forman Co.* v. *Kentucky*, 217 U. S. 563, 573 [30 S. Ct. 578, 54 L. Ed. 883]' . . . it has long been settled that a classification, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause of the Fourteenth

Amendment if any state of facts reasonably can be conceived that would sustain it. *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61, 78 [31 S. Ct. 337, 55 L. Ed. 369]; *Quong Wing* v. *Kirkendall*, 223 U. S. 59 [32 S. Ct. 192, 56 L. Ed. 350]; *Rast* v. *Van Deman & Lewis Co.*, 240 U. S. 342, 357 [36 S. Ct. 370, 60 L. Ed. 679]; *State Board of Tax Comm'rs* v. *Jackson*, 283 U. S. . . .[527, 537, 51 S. Ct. 540, 75 L. Ed. 1248]."

This court has also used similar language in describing permissible classification. "The legislature has a wide discretion in the classification of property for taxation and in granting exemptions. . . . The classification must be reasonable and not arbitrary and must be based upon a distinction which bears a fair and substantial relationship to the object of the legislation so that all who are similarly situated are treated alike." *First Federal Savings & Loan Assn.* v. *Connelly*, 142 Conn. 483, 491, 115 A. 2d 455, appeal dismissed, 350 U. S. 927, 76 S. Ct. 305, 100 L. Ed. 811; see also *Consolidated Diesel Electric Corporation* v. *Stamford*, 156 Conn. 33, 36, 238 A. 2d 410.

(b) The plaintiffs in the present case contend that there is no real difference between dividends and other forms of investment income and hence the singling out of dividend income for taxation purposes is arbitrary and amounts to a denial of equal protection of the law. Various courts, however, have sustained similar distinctions. In *Welch* v. *Henry*, 305 U. S. 134, 143-44, 59 S. Ct. 121, 83 L. Ed. 87, the United States Supreme Court upheld a state tax on dividends saying: "We think that the selection of such income for taxation at rates and with deductions not shown to be unrelated to an equitable distribution of the tax burden is not a denial of equal protection commanded by the Fourteenth Amendment. . . . Any classification of taxation is permissible which has reasonable relation to a legitimate end of governmental action. . . . And the distribution of a tax burden by placing it in part on a special class which

by reason of the taxing policy of the state has escaped all tax during the taxable period is not a denial of equal protection." Among a plethora of decisions upholding analogous distinctions are: *Randolph* v. *Simpson*, 410 F. 2d 1067, 1068 (5th Cir., 1969) (Florida ad valorem tax differently treating tangible and intangible personal property upheld); *Barhorst* v. *St. Louis*, 423 S. W. 2d 843, 846 (Mo.) (distinction between earned and unearned income upheld); *Personal Loan & Finance Co.* v. *Oklahoma Tax Commission*, 437 P. 2d 1015, 1020 (Okla.) (distinction between "single" corporations and those with "parents" upheld); *Johnson* v. *Donovan*, 290 Minn. 421, 188 N. W. 2d 864 ("recreational vehicles" a legitimate category for special tax treatment); *In re Opinion of the Justices*, ... N. H. ....., 276 A. 2d 821, 822 (gross income of individuals and business entities subject to tax at different rates).

It is not the province of this court to pass on the wisdom of the General Assembly's decision nor, despite the plaintiffs' arguments to the contrary, does the speed with which it enacted the legislation necessarily affect its validity. "Only if it appears that there is no rational basis for the classification so that it is patently arbitrary may it be set aside as patently arbitrary." *Virgo Corporation* v. *United States*, 384 F. 2d 569, 586 (3d Cir.). "As long as the statute may be justified on any reasonable theory, the legislature's determination will be upheld." *WHYY, Inc.* v. *Glassboro*, 50 N. J. 6, 13, 231 A. 2d 608.

We conclude that the plaintiffs have not sustained their heavy burden of showing that the legislature's decision to tax dividends while leaving other investment income untaxed is clearly capricious, arbitrary and unconstitutionally discriminatory as to them and that they have not successfully negatived "every conceivable basis which might support it." *Madden* v. *Kentucky*, 309 U. S. 83, 88, 60 S. Ct. 406, 84 L. Ed. 590.

We find ourselves in agreement with the comment by Professor Lester B. Snyder of the University of Connecticut School of Law in his article entitled "Tax Policy in the 1971 Connecticut General Assembly," 46 Conn. B. J. 136: "Although the Connecticut dividends and capital gains tax does not tax all intangible property income, it does represent a reasonable legislative attempt to tax the major items of intangible wealth. Interest income was excluded from the tax after a legislative determination that such a tax might be oppressive to low-income, or retired persons. While this judgment is quite debatable as a matter of fact or policy, it is not *per se* unconstitutional. Moreover, a quick glance at the wide variety of selective taxing schemes in this and other states clearly indicates that the long-standing pattern of taxation has been to single out particular items with exclusion or exemption of myriad others. For example, the property tax base in Connecticut, even as it applies to tangible property, has been continuously narrowed, the net effect being to levy a tax on only certain items of personal property and real estate; the Connecticut conveyance tax applies only to certain real estate and not to conveyances of other types of property, such as stocks and bonds; the sales tax is applicable only to particular sales of personal property; and taxes on business net income are levied only if the business happens to be a corporation. These value judgments, as to how broad or narrow to base a tax, must, of necessity, be left to the legislative branch of government under our separation of powers doctrine. Any attempt by the courts to unscramble any part of the complex scheme of state taxation, substituting their own judgment for what is or is not a sound tax policy would subvert the function of the judicial branch and ignore a policy of judicial restraint enunciated by the United States Supreme Court on many occasions in the past."

(c) Applying to the widow's exemption provided in § 12-506(c)(3) of the act, the same tests of constitutionality

which we have already discussed, we come to the conclusion that this exemption provision is invalid. As the plaintiffs properly maintain, the only difference between the status of a "person who is unmarried and a widow on the last day of her taxable year" and a person who is unmarried and a widower is that of sex. "[M]ere difference is not enough: the attempted classification 'must always rest upon some difference which bears a reasonable and just relation to the act in which the classification is proposed, and can never be made arbitrarily and without any such basis.'" *Hartford Steam Boiler Inspection & Ins. Co.* v. *Harrison*, 301 U. S. 459, 462, 57 S. Ct. 838, 81 L. Ed. 1223. As we said in *In re Application of Griffiths*, 162 Conn. 249, 258, ... A. 2d .....: "'The basis for a reasonable classification must show such a difference as to justify the division. "A proper classification . . . must embrace all who naturally belong to the class—all who possess a common disability, attribute or qualification and there must be some natural and substantial difference germane to the subject or purposes of the legislation between those within the class included and those whom it leaves untouched."' *St. John's Roman Catholic Church Corporation* v. *Darien*, 149 Conn. 712, 723, 184 A. 2d 42." See also *State* v. *Delgado*, 161 Conn. 536, 290 A. 2d 338.

Insofar as the record discloses, the special exemption granted to a widow is predicated solely on sex and the death of a spouse. While there may be some reason which would justify a tax statute which sets apart surviving spouses as a class for special treatment and within that class a subclass of female surviving spouses, no valid reason whatsoever for the latter discrimination solely on the basis of sex is disclosed in the body of the act nor has any been suggested to us. No other qualification such as need, a minimum income, dependent children or physical handicap is made a basis for this classification. Since all persons who have attained the age of sixty-five are granted the same

exemption (§ 12-506[c][2]) the discrimination cannot be justified on the basis that women have a statistically greater life expectancy. A statute which on its face discriminates on the basis of sex establishes "a classification subject to scrutiny under the Equal Protection Clause." *Reed* v. *Reed*, 404 U. S. 71, 75, 92 S. Ct. 251, 30 L. Ed. 2d 225. The equal protection clauses of the state and federal constitutions apply to all persons regardless of their sex. In *Reed* v. *Reed, supra*, the United States Supreme Court recently held that a provision of the Idaho probate code which gave preference to men over women when persons of the same entitlement class apply for appointment as administrator of a decedent's estate was unconstitutionally discriminatory, saying: "In applying that clause [the equal protection clause], this Court has consistently recognized that the Fourteenth Amendment does not deny to States the power to treat different classes of persons in different ways. *Barbier* v. *Connolly*, 113 U. S. 27 (1885) [5 S. Ct. 357, 28 L. Ed. 923]; *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61 (1911) [31 S. Ct. 337, 55 L. Ed. 369]; *Railway Express Agency* v. *New York*, 336 U. S. 106 (1949) [69 S. Ct. 463, 93 L. Ed. 533]; *McDonald* v. *Board of Election Commissioners*, 394 U. S. 802 (1969) [89 S. Ct. 1404, 22 L. Ed. 2d 739]. The equal protection clause of that amendment does, however, deny to States the power to legislate that different treatment be accorded to persons placed by a statute into different classes on the basis of criteria wholly unrelated to the objective of that statute. A classification 'must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike,'" citing *Royster Guano Co.* v. *Virginia*, 253 U. S. 412, 415, 40 S. Ct. 560, 64 L. Ed. 989. The unanimous opinion by Chief Justice Burger concluded by saying: "By providing dissimilar treatment for men and women who are thus similarly situated, the

challenged section violates the Equal Protection Clause." *Reed* v. *Reed*, *supra*, 77. There is nothing in the act itself which suggests any permissible legislative policy which would constitutionally justify discrimination because of sex in the amount of exemption allowed taxpayers by the act nor has any valid reason for this discrimination on the basis of sex been given on this reservation. In these circumstances, we must conclude that the discrimination solely on the basis of sex between the tax exemption afforded to persons who are widows on the last day of their taxable years vis-a-vis persons who are widowers on the last day of their taxable years is constitutionally impermissible in that it violates the equal protection clause. In the absence of some valid reason to the contrary, men and women similarly situated must be treated equally under the law.

It is pertinent to add that the invalidity of this one provision of the act does not result in the entire act being invalid. "To hold that legislation is valid as to one part and invalid as to another is not anomalous but consonant with principles long established. *State* v. *Wheeler*, 25 Conn. 290, 299. Where two or more parts of a statute are challenged, the test is whether they are so mutually connected and dependent as to indicate a legislative intent that they should stand or fall together. *Branch* v. *Lewerenz*, 75 Conn. 319, 324, 52 A. 658. If that test is applied to this case, it is clear that the part we sustain is separate and distinct from the part we hold to be invalid. They are entirely severable provisions." *Amsel* v. *Brooks*, 141 Conn. 288, 300, 106 A. 2d 152.

II.

We next consider the claim of the plaintiffs that "[c]hapter 224 is so ambiguously worded, internally inconsistent, unintelligible and loosely drafted as to be void for vagueness under the applicable due process provisions of the state and federal constitutions." They assert that "[a]

declaration by this Court that this Chapter is void for vagueness would have a salutary effect upon the legislative process in this State. It would encourage the General Assembly to meet its responsibilities by drafting tax legislation which is carefully considered and properly constructed rather than the midnight madness which this legislation portrays." The act is not free from ambiguity and certainly lacks the clarity to be desired and expected in revenue raising legislation. As specific problems arise and cases are presented for adjudication and a determination of the proper interpretation and application of the provisions of the act to particular situations, they will have to be resolved in due course. We must, however, decline to advise on abstract principles of law or to answer such a broad question as: "Are any of the sections of Chapter 224 void for vagueness?" See *United Oil Co.* v. *Urban Redevelopment Commission*, 158 Conn. 364, 373, 260 A. 2d 596; *Adams* v. *Rubinow*, 157 Conn. 150, 168, 251 A. 2d 49; *Holt* v. *Wissinger*, 145 Conn. 106, 109, 139 A. 2d 353.

This principle applies as well to the claim of the plaintiffs that the act fails to provide definite procedural relief which satisfies the requirements of due process of law. The act expressly provides (§ 12-521) that any person aggrieved by the action of the tax commissioner in fixing the amount of any tax, penalty or interest provided by chapter 224 may apply to the commissioner for a hearing and a correction. Section 12-522 provides for an appeal to the Superior Court by any person aggrieved because of any order, decision, determination or disallowance of the tax commissioner. There is no suggestion in the plaintiffs' complaint or in the stipulation of facts that any of the plaintiffs have even sought procedural relief, much less been denied due process of law in any manner concerning any relief to which a right has been asserted. As we have already stated, "a plaintiff, in challenging the constitutionality of a statute, must sustain the burden of proving that the effect or impact of

the challenged statute on him adversely affects a constitutionally protected right which he proves he has. 'This means a right which he proves that he has under the facts of his particular case and not merely under some possible or hypothetical set of facts not proven to exist.'" *Adams* v. *Rubinow*, *supra*, 152. "A statute may operate in a manner consistent with constitutional requirements when applied to one set of circumstances, although as to another it may produce a result which makes its operation unconstitutional. . . . Put another way, the constitutional validity of a statute must be tested by its effect on the one who challenges it under the particular circumstances of his case and not under some other and different circumstances." *State* v. *Sul*, 146 Conn. 78, 81, 147 A. 2d 686.

III.

A further contention of the plaintiffs is that the act unlawfully delegates to the tax commissioner power to adopt and enforce rules and regulations relating to the administration and enforcement of the act and by references to federal income tax law has improperly delegated to the United States Congress a portion of the legislative power of the Connecticut General Assembly.

As to the first of these contentions, it is the claim of the plaintiffs that the authority granted to the tax commissioner under §§ 12-508, 12-510, 12-516, 12-517 and 12-518 of the act violates the constitution of Connecticut, article first, § 8, articles second and third, § 1, in that it is an unlawful delegation of legislative power to the commissioner. In addition, they contend that these sections of the act undertake to delegate substantial duties to the commissioner without prescribing adequate standards for the exercise of his discretion. These contested sections of the act authorize the tax commissioner to prescribe forms for tax returns, to require the submission of data and records pertinent to

the determination of the amount of tax due, to investigate and verify the accuracy of returns and, in general, to adopt and enforce rules and regulations relating to the administration and collection of the tax.

There is a clear distinction between the legislative function of defining and imposing a tax, which function is nondelegable, and the ministerial and administrative procedures to be followed in the assessment and collection of the tax. It is well established that "[a] Legislature, in creating a law complete in itself and designed to accomplish a particular purpose, may expressly authorize an administrative agency to fill up the details by prescribing rules and regulations for the operation and enforcement of the law." *State* v. *Stoddard*, 126 Conn. 623, 628, 13 A. 2d 586. The power granted to an administrative board or official may include, but is not limited to, the establishment of filing requirements, the hearing of administrative appeals, the finding of facts, and the determination of when as opposed to how and to what extent a tax may be imposed. See *Moore* v. *Langton*, 92 R. I. 141, 167 A. 2d 558; *Opinion of the Justices*, 96 N. H. 513, 68 A. 2d 859; *Opinion of the Justices*, 97 N. H. 533, 81 A. 2d 845.

The legislative power constitutionally to delegate authority is, of course, not unlimited. For a delegation to be constitutionally sustained, "it is necessary that the statute declare a legislative policy, establish primary standards for carrying it out, or lay down an intelligible principle to which the administrative officer or body must conform, with a proper regard for the protection of the public interests with such degree of certainty as the nature of the case permits, and enjoin a procedure under which, by appeal or otherwise, both public interest and private rights shall have due consideration." *State* v. *Stoddard*, *supra*.

It is the plaintiffs' principal contention that the legislature failed to define with the requisite specificity primary

standards governing the exercise of the tax commissioner's authority and that as a result "[t]he defects of the statute itself, combined with the lack of adequate standards, has fashioned the Commissioner into a legislator, and in many cases into a judge." We do not agree. While the act does not expressly state the purpose for which it was enacted, it can hardly be doubted, in the light of its legislative history, that the act was designed to raise much needed revenue in a manner consistent with the now generally settled federal practices and principles of income taxation. The General Assembly specifically levied the tax, prescribed the rate and defined the income subject to taxation as well as the persons who are required to pay. §§ 12-505, 12-506. It then authorized the tax commissioner to (1) prescribe the information required of the taxpayer, (2) to design forms for returns, (3) to require the submission of copies of federal income tax returns and supporting records, (4) to extend time limitations, and (5) to promulgate regulations for enforcement of the act and collection of the prescribed tax. §§ 12-508, 12-510, 12-516, 12-517, 12-518. In the comprehensive and complex area of taxation of income, it is neither uncommon nor unwise for a legislature to defer to the expertise of an official or group of officials in the areas of regulations and administration. See *Commissioner of Internal Revenue* v. *Stidger*, 386 U. S. 287, 296, 87 S. Ct. 1065, 18 L. Ed. 2d 53; *Anderson* v. *Tiemann*, 182 Neb. 393, 401, 155 N. W. 2d 322; *Columbia Gulf Transmission Co.* v. *Barr*, 194 So. 2d 890, 895 (Miss.). "The legislature cannot delegate its power to make a law, but it can make a law to delegate a power to determine some fact or state of things upon which the law makes, or intends to make, its own action depend. To deny this would be to stop the wheels of government. There are many things upon which wise and useful legislation must depend which cannot be known to the law-making power, and must, therefore, be a subject of inquiry and determination outside of the halls of legisla-

tion." *Field* v. *Clark*, 143 U. S. 649, 694, 12 S. Ct. 495, 36 L. Ed. 294.

As long as revenue legislation sets out with specificity the rate of the tax, the instances where it is to be imposed and those who will be liable to pay it, there is no impermissible delegation of legislative power merely because the details of regulation and enforcement are left to administrative action. The plaintiffs have not established that the act unconstitutionally delegates to the tax commissioner any of the legislative powers of the General Assembly or that the standards the act prescribes for the exercise of the administrative and enforcement powers granted to the commissioner are not precise enough to serve as a "sufficient guide for the exercise of the discretion" which he must exercise. *Connecticut Baptist Convention* v. *McCarthy*, 128 Conn. 701, 705, 25 A. 2d 656. As we noted in *Hardware Mutual Casualty Co.* v. *Premo*, 153 Conn. 465, 480, 217 A. 2d 698, it is always conceivable that maladministration of the statute by the commissioner, in disregard of primary standards prescribed by the legislation might constitute action which would have an unconstitutional impact on a taxpayer. "But," as we there said, "that is not this case. The plaintiffs have wholly failed to prove any such impact on themselves. This court cannot strike down a legislative enactment as unconstitutional merely because difficulties may be encountered in its administration, or on the mere possibility that it may be improperly administered. *Lyman* v. *Adorno*, 133 Conn. 511, 530, 52 A. 2d 702."

The plaintiffs' second contention in this context is that the act's incorporation by reference of federal income tax law amounts to an unlawful delegation to Congress of the legislative power of the General Assembly and violates the tenth amendment to the constitution of the United States as well as article first, § 8, articles second and third, § 1 of the constitution of Connecticut. Their claim is that although

General Assembly may properly incorporate by refer-
e any provision of federal law, any incorporation of
s nature must necessarily make reference to the incorpo-
ed law as it existed on a particular date. They point out
t the various corporation business tax statutes previ-
ly considered by this court make reference to federal
as it existed "on the last day of the income year."
First Federal Savings & Loan Assn. v. *Connelly*, 142
nn. 483, 492, 115 A. 2d 455, appeal dismissed, 350 U. S.
, 76 S. Ct. 305, 100 L. Ed. 811; *Singer Mfg. Co.* v. *Gil-
ric*, 98 Conn. 192, 196, 118 A. 919. Thus, they contend
t since the act does not expressly adopt federal income
law as it existed on a specific date that it must, accord-
ly, be construed to refer not only to the federal tax law
it existed when the act was passed but also to any future
endments which may be adopted by Congress. It is their
sition that this constitutes an attempt by the General
sembly to adopt federal tax law as it may be enacted by
ngress in the future and hence is not a lawful incorpora-
n by reference but is rather an unconstitutional delega-
n of state legislative power to the Congress.

We are constrained to note that the validity of this argu-
nt is questionable since it is predicated on an assump-
n that the statute must be construed as an attempt by
e General Assembly to adopt amendments which Con-
ess may in the future make to federal tax law. Since
e act makes no express provision in this regard, the in-
rpretation claimed by the plaintiffs is not a necessary one.
e *Anderson* v. *Tiemann, supra.* "Statutes are to be con-
ued in light of their legislative history, their language,
e purpose they are to serve, and the circumstances sur-
unding their enactment. *Connecticut Light & Power Co.*
Sullivan, 150 Conn. 578, 581, 192 A. 2d 545; *Mack* v.
ars, 150 Conn. 290, 294, 188 A. 2d 863; *Oppenheimer* v.
nnecticut Light & Power Co., 149 Conn. 99, 102, 176 A.
63." *Hartford Electric Light Co.* v. *Water Resources*

Commission, 162 Conn. 89, 97, ... A. 2d ..... Furthermore, even if the interpretation which the plaintiffs claim is a correct one and the act were construed to incorporate not only federal tax law as it existed in 1971 when the act was adopted but also such amendments as Congress might adopt in the future, there is at least some authority that such legislation is constitutionally permissible. See *Alaska Steamship Co.* v. *Mullaney*, 84 F. Supp. 561 (D. Alas.), affirmed, 180 F. 2d 805 (9th Cir.); *Hickel* v. *Stevenson*, 416 P. 2d 236, 238 (Alas.); *In re Lasswell*, 1 Cal. App. 2d 183, 36 P. 2d 678; *People ex rel. Pratt* v. *Goldfogle*, 242 N. Y. 277, 151 N. E. 452; *Commonwealth* v. *Alderman*, 275 Pa. 483, 151 N. E. 452; but see *Wallace* v. *Commissioner of Taxation*, 289 Minn. 220, 184 N. W. 2d 588; *Hutchins* v. *Mayo*, 143 Fla. 707, 197 So. 495; *Thorpe* v. *Mahin*, 43 Ill. 2d 36, 250 N. E. 2d 633; *State* v. *Intoxicating Liquors*, 121 Me. 438, 442, 117 A. 588; *Featherstone* v. *Norman*, 170 Ga. 370, 153 S. E. 58; *Cheney* v. *St. Louis Southwestern Ry. Co.*, 239 Ark. 870, 872, 394 S. W. 2d 731; *Santee Mills* v. *Query*, 122 S. C. 158, 115 S. E. 202; *State ex rel. Kirschner* v. *Urquhart*, 50 Wash 2d 131, 310 P. 2d 261; *Dawson* v. *Hamilton*, 314 S. W. 2d 532 (Ky.); *Opinion of the Justices*, 239 Mass. 606, 133 N. E. 453.[3]

We refrain, however, from determining at this time this question of statutory interpretation and constitutional law. The precise question has neither been properly raised nor adequately presented in these proceedings. Moreover, the stipulation of facts does not indicate nor has our attention been called to any changes in federal tax law relevant to the issues in this case which have been effected since the passage of the act. The plaintiffs have not demonstrated how their rights have in any way as yet been infringed by

3. It is to be noted that some states have avoided any question about this problem by means of amendment of their constitutions. See *Matter of Garlin* v. *Murphy*, 51 Misc. 2d 477, 273 N. Y. S. 2d 374; N. Y. Const., art. 3 § 22; Colo. Const., art. 10 § 9.

the provisions of these portions of the act, and we will not presume that the General Assembly will not enact further or clarifying legislation at or before the time any change in the federal tax law becomes effective. At the present time, so far as the plaintiffs are concerned, the issue is merely academic and this court will not answer merely academic questions. *Congress & Daggett, Inc.* v. *Seamless Rubber Co.*, 145 Conn. 318, 323, 142 A. 2d 137; *Burns* v. *Seymour*, 141 Conn. 401, 406, 106 A. 2d 759.

IV.

A further contention of the plaintiffs is that a proper interpretation of § 12-506[4] of the act requires that the basis for computing a capital gain or loss can be no earlier than December 31, 1970. Their argument is threefold: First, they maintain that § 12-506 of the General Statutes should, as a matter of statutory construction, be interpreted not to adopt the federal basis for the taxation of capital gains but to tax, when realized, only accretions in value after December 31, 1970. Second, they argue that § 55-3[5] of the General Statutes requires that § 12-506 be construed to allow the taxpayer to use instead of the federal basis for computing capital gains the fair market value of the asset on December 31, 1970. Finally, they contend that if the statute is construed as adopting the federal basis for the computation of capital gain that such a construction would

4. "[Public Acts, Spec. Sess., June 1971, No. 8 § 10] Sec. 12-506. IMPOSITION OF TAX. (a) A tax is hereby imposed at the rate of six per cent on all dividends and gains from the sale or exchange of capital assets occurring after December 31, 1970, which have been earned, received in fact or constructively, accrued or credited to the taxpayer during his taxable year subject to the exemptions allowed in subsection (c) of this section."

5. "[General Statutes] Sec. 55-3. LIMITATION OF EFFECT OF CERTAIN ACTS. No provision of the general statutes, not previously contained in the statutes of the state, which imposes any new obligation on any person or corporation, shall be construed to have a retrospective effect."

render the statute impermissibly retroactive under the United States and Connecticut constitutions.

The plaintiffs' arguments center around the words in § 12-506 which impose a tax "on all dividends and gains . . . occurring after December 31, 1970." Their contention is that the word "occurring" as it is used in the statute is synonymous with the term "happening" and that the latter carries with it a connotation different and distinct from the traditional federal income tax concept of realization of gain or loss. We do not agree. "Courts, in construing statutes, consider their legislative history, their language, their purpose, and the circumstances surrounding their enactment." *Mack* v. *Saars*, 150 Conn. 290, 294, 188 A. 2d 863; *Delinks* v. *McGowan*, 148 Conn. 614, 618, 173 A. 2d 488. "Legislative intent is to be found not in what the legislature meant to say but in the meaning of what it did say. *Mad River Co.* v. *Wolcott*, 137 Conn. 680, 686, 81 A. 2d 119. We are called upon to look beyond the literal meaning of the words to the history of the law, its language, considered in all its parts, the mischief the law was designed to remedy, and the policy underlying it. *Giammattei* v. *Egan*, 135 Conn. 666, 668, 68 A. 2d 129. We must look, also, to the basic policy as disclosed by pre-existing legislation and the circumstances which brought about the enactment of the law under consideration. *Cedar Island Improvement Assn.* v. *Clinton Electric Light & Power Co.*, 142 Conn. 359, 364, 114 A. 2d 535." *Lee* v. *Lee*, 145 Conn. 355, 358, 143 A. 2d 154. "When two constructions are possible, courts will adopt the one which makes the statute effective and workable, and not one which leads to difficult and possibly bizarre results." *Muller* v. *Town Plan & Zoning Commission*, 145 Conn. 325, 331, 142 A. 2d 524; *Bridgeport* v. *Stratford*, 142 Conn. 639, 644, 116 A. 2d 508.

From a close examination of the entire act, it is obvious that the legislature intended to incorporate and adopt the

federal basis for computation of capital gain and loss.[6] Section 12-505 specifically states: "Gains from the sale or exchange of capital assets means net gains as defined for federal income tax purposes." While there is some ambiguity in the meaning of "net gains" (a problem which we will discuss later in this opinion), we believe that the reference to the federal income tax structure is of controlling significance and decisive on the question of what basis is to be used in computing the tax on gains from the sale or exchange of capital assets.

"For federal income tax purposes" a capital gain is one "realized" through a sale or exchange of the asset. Internal Revenue Code § 1001(a); *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 249, 52 S. Ct. 538, 76 L. Ed. 1083. Absent such a sale or exchange, no taxable event has taken place even though the asset may, from an investment standpoint, be worth more to the holder than its initial cost plus adjustments for improvements. While the plaintiffs appear to agree that under the provisions of the act realization of gain is the taxable event,[7] they nevertheless contend that the only gains which "occur" after December 31, 1970, are the increases in value of the asset after that date. Thus, while they accept the established concept of no taxation until realization, they reject the equally well established corollary principle that when gains are realized they are then taxed on the difference between the value at the time of sale or exchange and the adjusted basis which is usually the initial cost.[8]

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6. For a discussion of cases involving state legislation incorporating by reference the provisions of the federal Internal Revenue Code as they affect the determination of capital gains and losses, see Coyne, "State Taxation of Capital Gains: Is Use of the Federal Basis Constitutional?" 24 National Tax Journal 521.

7. There is at least some indication that, for federal purposes, gains not realized may not constitutionally be taxed. See *Eisner* v. *Macomber*, 252 U. S. 189, 214, 40 S. Ct. 189, 64 L. Ed. 521.

8. Under the provisions of § 1053 of the Internal Revenue Code, if the asset was purchased by the taxpayer prior to March 1, 1913,

We find no indication either in the language of the act itself or in its legislative history that the General Assembly intended to adopt any other standard for taxing capital gain than that employed for federal tax purposes to which standard the act makes specific reference. Only gains realized after December 31, 1970, are taxed under the act. The fact that the amount of the tax depends, among other things, on the cost of the asset which may have been acquired prior to the enactment of the tax does not make the tax retrospective. The tax being imposed at the time of realization of the gain operates only in a prospective manner and, accordingly, does not operate counter to the proscription of § 55-3 of the General Statutes.

The plaintiffs argue that the act so interpreted violates the due process of law provisions of the United States and Connecticut constitutions. Their argument is, essentially, that a taxpayer's cost basis may have as its origin a transaction or valuation which took place over fifty years ago and thus the tax imposed on the profit resulting from the sale of the asset is not only retroactive but excessively so and constitutes a denial of due process. This argument, however, disregards the concept of taxation of the realization of the capital gain. While the value of a taxpayer's property may increase over a period of years, he realizes the profit and capital gain only on the sale or exchange of the property. The established concept of capital gain taxation and as it is implemented in the act is that the tax is levied on the final transaction, not on the gradual accretion in value.

There is authority for the proposition that a tax may be declared unconstitutional as a violation of due process

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then his basis, subject to adjustment, is the fair market value of the asset on March 1, 1913. In addition, there are numerous other sections of the Internal Revenue Code which define, adjust or allocate a taxpayer's basis depending on the circumstances surrounding a transaction. See, for example, Internal Revenue Code §§ 301(d), (f), 307, 1336 and others.

when it is imposed on an event which took place long before the taxing statute was enacted; see *People ex rel. Beck* v. *Graves,* 280 N. Y. 405, 21 N. E. 2d 371; but that circumstance is not present here. The capital gains tax is not levied on paper profits which accrue to the taxpayer while he owns the property but on profits which are, in fact, realized by the taxpayer when he sells the asset. The distinction was well pointed out by the United States Supreme Court in *MacLaughlin* v. *Alliance Ins. Co.,* 286 U. S. 244, 249, 250, 52 S. Ct. 538, 76 L. Ed. 1083, which dealt with a similar problem involving retroactivity, "[r]ealization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property, not realized as gain by its sale or other disposition, may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period, . . . it is nevertheless a gain from capital investment which, when realized, by conversion into money or other property, constitutes profit which has consistently been regarded as income within the meaning of the Sixteenth Amendment and taxable as such in the period when realized. . . . Congress, having constitutional power to tax the gain, and having established a policy of taxing it, . . . may choose the moment of its realization and the amount realized, for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in value in the earlier years, assuming without deciding that it had the power, cannot preclude it from taxing the gain in the year when realized, any more than in any other case, where the tax imposed is upon realized, as distinguished from accrued, gain."

Various state courts when considering similar problems of retroactivity of taxing statutes have reached substantially identical conclusions. *Fullerton Oil Co.* v. *Johnson,* 2 Cal. 2d 162, 168, 39 P. 2d 796; *Fidelity & Columbia Trust*

Co. v. *Reeves*, 287 Ky. 522, 154 S. W. 2d 337; *City National Bank* v. *State Tax Commission*, 251 Iowa 603, 102 N. W. 2d 381; *Norman* v. *Bradley*, 173 Ga. 482, 160 S. E. 413; *Sweetland* v. *Franchise Tax Board*, 192 Cal. App. 2d 316, 13 Cal. Rptr. 432; *Olvey* v. *Collector of Revenue*, 233 La. 985, 99 So. 2d 317. *Thorpe* v. *Mahin*, 43 Ill. 2d 36, 250 N. E. 2d 633, appears to have reached a contrary conclusion but the decision was based primarily on the court's interpretation of the Illinois statute—Ill. Rev. Stat. c. 120, art. 2 (1969)—which expressly provided that the tax should operate prospectively beginning August 1, 1969.

A tax on realized capital gain does not operate in a retroactive manner merely because ascertainment of the amount of the gain is measured by the difference between the sale price received during the tax year and the taxpayer's basis which may have been established at some earlier time. The act is retroactive only to the extent that it taxes the realization of gain after December 31, 1970. This limited retroactive application is of no consequence. *Welch* v. *Henry*, 305 U. S. 134, 148, 59 S. Ct. 121, 83 L. Ed. 87.

V.

The remaining questions reserved for our advice involve questions of interpretation of the language of three provisions of the act. The first and most important is whether in computing the amount of tax owed a deduction is allowed for long term capital gains equivalent to the deduction provided to taxpayers by § 1202 of the Internal Revenue Code. As noted before, the tax is imposed on "all dividends and gains from the sale or exchange of capital assets" which, by the terms of § 12-505, means "net gains as defined for federal income tax purposes, after due allowance for losses and holding periods." The plaintiffs maintain that this language incorporates § 1202 of the Internal Revenue Code which provides for a deduction from gross income of 50

percent of the excess of net long term capital gain less net short term capital loss. Under that section of the Internal Revenue Code, assuming that one does not select the alternative tax for long term capital gains, effectively only one-half net capital gain which is long term is subject to the federal income tax. The precise question we are called on to answer then is whether "net gains" as that term is used in § 12-505 should be computed in accordance with § 1202 of the Internal Revenue Code which provides preferential treatment for gains from the sale or exchange of assets which are classed as long term capital gains. In other words, does the language of § 12-505 mean that the proper base on which the 6 percent tax is imposed is 100 percent of net capital gain which is long term or 50 percent?

Despite its obvious importance in the tax plan implemented by the act, the language chosen by the legislature to define the base for imposition of the tax on capital gain is singularly lacking in clarity. As we have noted, § 12-505 defines "gains from the sale or exchange of capital assets" to mean "net gains as defined for federal income tax purposes, after due allowance for losses and holding periods but not nonrecognition of gains, all as provided under federal income tax law." A close examination of the federal Internal Revenue Code, however, discloses that neither the term "net gains" nor its singular counterpart is used in those federal statutes. To the extent that the term is used on the federal tax form for individual returns, it is devoid of meaning in the present context since "net gain" is used to describe the amount of gain both before and after the allowance of the § 1202 deduction. In these circumstances, we must seek to ascertain the meaning of the statute by the application of the settled rules for statutory construction to which we have hereinbefore referred, including a careful analysis not only of the language of the act but the history and policy underlying it. *Connecticut Light & Power Co.* v. *Sullivan*, 150 Conn. 578, 581, 192 A. 2d 545.

Some guidance is found in the repeated references to federal income tax law and particularly the provision that the taxable net gains are those defined for federal income tax purposes "after due allowance for losses and holding periods." While the reference to losses has little relevance to our present problem, the phrase "holding periods" does have decided significance. Under § 1222 of the federal Internal Revenue Code, a taxpayer may treat an item of capital gain or loss as long term only if the gain or loss results from "the sale or exchange of a capital asset held for more than 6 months." Since § 12-505 refers to "holding periods" there is a clear indication that the legislature intended by the use of that term to afford a different treatment to long term as opposed to short term capital gains. That differing treatment will only result if the 50 percent deduction for net long term capital gains less net short term capital losses is allowed.

The defendants contend that the phrase "after due allowance for losses and holding periods" as it is used in § 12-505 is not intended to define "net gains" but to modify the word "losses." Thus, they maintain that the reference to "holding periods" in the statute only affects the treatment of losses and not the treatment of gains. In support of this position, they rely on § 1211(b) of the federal Internal Revenue Code as amended in 1969. That particular section allows a taxpayer to deduct from ordinary income a portion of his net loss if his capital losses exceed his capital gains. Similarly, § 1212(b) of the federal Internal Revenue Code provides for long and short term adjustments to loss carryovers.

While the defendants are undoubtedly correct in their assertion that holding periods are an integral part of both of these federal tax provisions, this fact is not of significance in relation to the tax on capital gains imposed by the

act. Section 1211(b) of the federal Internal Revenue Code defines the tax consequences when, in any given year, the total of a taxpayer's capital transactions results in a net loss. Since § 12-505 of the General Statutes imposes a state tax on only "dividends and *gains*" (emphasis added) it is clear that a Connecticut taxpayer will not, in any one year where losses exceed gains, have a state tax liability resulting from his capital transactions, since, in that circumstance, he will have no net gain. In a year of net capital loss, the only effect § 1211(b) of the federal Internal Revenue Code will have on a taxpayer's total state tax liability is a lessening of his adjusted federal income and consequent increase in the § 12-506(c)(1) exemption which will be applied to his taxable dividend income. Similarly, § 1212(b) of the federal Internal Revenue Code deals only with the computation of capital loss carry-over. While it is conceivable that application of the complex rules of that section will affect a taxpayer's state capital gains tax liability in future years depending on whether the assets sold to produce a net capital loss were held for more than six months, the application of this particular meaning of "holding periods" produces a rather curious result. The defendants would have us hold that an individual is taxed on the full amount of his capital gain without regard to its long or short term character yet, if a net capital loss is sustained in any one tax year, then a whole set of complex rules, wholly dependent on the length of time the assets were held, would come into play. It is inconceivable that the legislature intended this result particularly in light of their use of the phrase "all as provided under federal income tax law" immediately after the reference to allowances for holding periods and losses. While the statutory language is far from unambiguous, the most reasonable interpretation of this language is that it was intended to permit the allowance of the § 1202 deduction.

The defendants also call our attention to § 1250 of the federal Internal Revenue Code and point out that that particular section deals with both capital gains and holding periods. Section 1250 is the compilation of a rather complex set of rules governing the treatment of gain from the sale or exchange of certain depreciable realty. Without dwelling on its subtleties, it is sufficient to note that § 1250 provides that under certain circumstances gain from the sale of property on which depreciation allowances were allowed will be treated as ordinary income. The effect of this section then, as far as Connecticut is concerned, is to reduce the amount of state taxable gain. But the operation of § 1250 on the Connecticut capital gains and dividends tax is not by virtue of the reference in § 12-505 to "holding periods" but rather by virtue of the repetitive reference in the statute to federal income tax law.

The defendants' arguments relative to specific sections of the federal Internal Revenue Code merely enumerate possible sections to which the term "holding periods" may refer but they in no way illustrate why § 12-505 does not incorporate by reference all sections of the federal Internal Revenue Code when it refers to "net gains as defined for federal income tax purposes." In this regard, the defendants contend that "net gains" as the term is used in the statutes must refer to "net capital gain" which is defined by § 1222(9) of the federal Internal Revenue Code to be the excess of gains from sales or exchanges of capital assets over the losses from such sales or exchanges without reference to the 50 percent deduction for net long term capital gains less short term capital losses provided by § 1202. While it is certainly possible that the legislature meant to use the term "net capital gain" rather than "net gain" it nevertheless did not do so. "It is the expressed intent of the legislature which controls, and that intent is to be found in the meaning of what it says"; *Adams* v. *Vaill*, 158 Conn. 478, 483, 262 A. 2d 169; and not some unexpressed

or supposed state of mind of the General Assembly. See *Rivera* v. *I. S. Spencer's Sons, Inc.*, 154 Conn. 162, 166, 223 A. 2d 808. The language of the statute shows a clear intent on the part of the legislature to adopt, insofar as it was practical, the federal system for taxing capital gains income. When it departed from the federal income tax law, it did so specifically. In this light, it would be unwarranted and unreasonable to hold that "net gains" as that term is used in § 12-505 of the General Statutes did not incorporate the 50 percent deduction of net long term capital gains less net short term capital loss provided for in § 1202 of the federal Internal Revenue Code.

This interpretation of the act finds support not only in the language of the statute itself but most significantly in its legislative history. The first capital gains tax was enacted by the General Assembly in 1969 by Public Act No. 1 of the June 1969 session of the General Assembly, printed as chapter 224 (§§12-505 through 12-522 of the General Statutes). This act, which we will hereafter refer to as the 1969 act, was repealed by the 1971 act which is the subject of the present action. While the language of the 1969 act was different in many respects from the one under consideration here, it did define gains from the sale or exchange of capital assets to mean "'net gain' as that amount is computed under the internal revenue code of the United States." In Regulation No. 12-518-1(a) and (b), the tax commissioner ruled that the 1969 statute applied to capital gains "which are recognized and taxable for federal income tax purposes . . . 'net gain' means the combination of net long-term capital gains and net short-term capital gains less the smaller of fifty per cent of such combination or fifty per cent of net long-term capital gain." The Tax on Capital Gains, 31 Conn. L. J., No. 23, p. 11. Thus, when the General Assembly enacted Public Act No. 8 on the same subject during the 1971 special session, it can

be presumed that it did so with knowledge of the tax commissioner's interpretation of the phrase "net gain" and his regulation for payment of the tax on 50 percent rather than 100 percent of net long term capital gain less net short term capital loss. While the 1971 legislature made some minor changes from the language of the 1969 act, such as changing "net gain" to "net gains" and "as that amount is computed under the internal revenue code of the United States" to "as defined for federal income tax purposes" it also expressly added the further provision "all as provided under federal income tax law." The conclusion is inescapable that the 1971 legislature used the term "net gains" not only in the light of federal income tax practice but in light of the definition of that term in the administrative regulation then in force. *Shell Oil Co.* v. *Ricciutti*, 147 Conn. 277, 285, 160 A. 2d 257. If it in fact intended to deviate from federal income tax policy and to change existing state law by imposing the tax on 100 percent of net capital gain rather than allowing the § 1202 deduction, it could easily have so indicated. We not only find no such indication but the changes which were adopted in 1971 indicate to the contrary. We conclude that the answer to reserved question 17 is "No" and the answer to reserved question 18 is "Yes" and that insofar as the deduction for 50 percent of net long term capital gain less net short term capital loss is concerned it must be allowed.

The last two inquiries raised on this reservation concern the exemption afforded all taxpayers under § 12-506(c) of the General Statutes and the question whether net capital loss may be used to offset dividend income. As to the first problem, § 12-506(c)(1) provides that the normal exemption shall be $2000 "multiplied by a fraction whose numerator is dividend and capital gain income" and whose denominator is the taxpayer's federal adjusted gross income less certain other specified items of income. The plaintiffs maintain that, under certain circumstances, the

exemption fraction converted to percentage can exceed 100 percent thus resulting in an exemption greater than $2000. An example of this would be a situation where an individual receives all his income from dividends. Since the first $100 of dividend income is not taxed for federal purposes but is taxed under the 1971 act, the exemption fraction in percentage terms will inevitably exceed 100 percent.

From a review of the exhibits which include the 1971 Connecticut Capital Gains Tax Returns of the plaintiffs Marsh and Miller, we note that only the plaintiff Marsh listed an exemption fraction computed at greater than 100 percent. His argument for the greater exemption is based on the fact that the numerator of the exemption factor included the full amount of his capital gains whereas the denominator, his federal adjusted gross income, takes into account the 50 percent deduction provided for by § 1202 of the federal Internal Revenue Code. Our decision on the meaning of "net gain" as that term is used in § 12-505 of the General Statutes effectively sets this controversy to rest as to him since we have concluded that the "capital gain income" which is part of the numerator of the exemption fraction is computed in accordance with the provisions of the federal Internal Revenue Code with due regard for the deduction provided for in § 1202 of that code. Thus, as to these plaintiffs, the question whether under any circumstances the exemption may exceed $2000 is academic and we decline to answer it.

We turn next to the question whether net capital losses may be used to reduce taxable dividends. Section 12-506 provides that a 6 percent tax is imposed on "all dividends and gains." The plaintiffs argue that since gains are computed with regard to an allowance for losses, net capital losses may be used to reduce the total of dividends subject to the tax. We do not agree. The statute provides for the

taxation of only two different forms of income—from dividends and from capital gains. As we have noted, it does not, as does the federal income tax, tax other forms of income such as interest, rents or earnings from labor. Because the state act selects only these two forms of income for taxation, the provision of federal tax law allowing for a limited deduction of net capital loss from total income is not applicable, although we note that to some extent federal law will affect loss carry-overs in years after 1971. See Int. Rev. Code of 1954 §§ 1211(b), 1212(b). The provisions of the federal Internal Revenue Code which are incorporated into computation of the state tax on dividends and capital gains are generally only those which relate to those two specific subjects of tax. The incorporation does not extend to an allowance of net capital losses to reduce taxable dividend income and it does not appear that either the intent or the language of the act permits it. Accordingly, the answer to reserved question 20 is "No."

VI.

The Superior Court is advised as follows: We have been restricted, as we indicated at the beginning of this opinion, to the facts set forth in the stipulation, and on these facts we cannot find that the plaintiffs have sustained their burden of proving unconstitutionality except as to that portion of the act which purports to provide an exemption to any person who is unmarried and a widow on the last day of her taxable year which is two and one-half times the exemption amount as calculated in subdivision (1) of § 12-560(c). As we have noted, some of the questions were not pressed in this court. Some of the remaining questions propounded are academic and as to some others the plaintiffs have not established their entitlement to an answer or an answer cannot be given with greater precision than indicated in our discussion of the question. Subject to

these comments: Questions 1 (a) and (b); 7 (a), (b), (c), (d) and (e); 15 (a) and (b); 17, 19 and 20 in the reservation are answered "No"; and questions 3 (a), (b) and (c); 12, 13, 14, 16 and 18 are answered "Yes."

No costs will be taxed in this court in favor of any party.

In this opinion the other judges concurred.

SUPREME COURT

June Term, 1972

EUGENE F. PETERSON ET AL. v. JOHN L. SULLIVAN, TAX COMMISSIONER

Appeal from a decision of the defendant disallowing the plaintiffs' claim for a tax refund, brought to the Superior Court in Hartford County and reserved by the court, *Rubinow, J.*, for the advice of this court.

James R. Fogarty, Jr., with whom was *Ronald O. Dederick*, for the plaintiffs.

Ralph G. Murphy, assistant attorney general, with whom were *John M. Dunham* and *Richard K. Greenberg*, assistant attorneys general, and, on the brief, *Robert K. Killian*, attorney general, for the defendant.

HOUSE, C. J. Although this case involves many of the same issues which were considered in *Kellems* v. *Brown*, 163 Conn. (34 Conn. L. J., No. 6, p. 1), decided this day and to which we will refer as the *Kellems* case, it concerns an earlier act of the legislature enacted as Public Act No. 1 of the June, 1969, session of the General Assembly, printed as chapter 224, §§ 12-505 through 12-522 of the General Statutes. This act, which we will hereafter refer to as the 1969 act, was repealed effective August 15, 1971, by Public Act No. 8 of the June, 1971, special session of the General Assembly. The action was brought in the nature of an appeal from a decision of the defendant tax commissioner denying the plaintiffs' claim for a refund of a capital gains tax which they had paid. The parties stipulated to the relevant facts and the Superior Court reserved the case to this court for advice.

The plaintiffs are residents of Greenwich, Connecticut. On July 1, 1969, they owned various capital assets which they had acquired prior to that date and which were not situated in Connecticut. During the period from July 1, 1969, through December 31, 1969, they sold or otherwise disposed of those assets in sales or exchanges which were consummated through brokerage firms in New York, where all deliveries occurred. On or before April 15, 1970, they timely filed, on a form prescribed by the tax commissioner, a Connecticut Capital Gains Tax Return for the period July 1 through December 31, 1969, and paid a tax of $17,701.56. This return is hereafter referred to as the "original return." In accordance with the directions of the tax commissioner, the plaintiffs computed their net capital gain in their original return by deducting the adjusted basis, *i.e.*, the cost of the capital assets, from the proceeds derived from the sales and exchanges. On or about July 1, 1970, the plaintiffs filed an amended return covering the same period. This return computed taxable gain or loss by subtracting the fair market value of the assets on July 1, 1969, or their original cost, whichever was greater, from the proceeds derived from their sale or exchange. The resulting computation in their amended return showed a net capital loss. The plaintiffs have claimed a refund of $17,701.56 as an overpayment of their capital gains tax which claim for a refund was denied by the tax commissioner on October 1, 1970. The plaintiffs exhausted all administrative remedies available to them and thereupon took the present appeal. The defendant contends that the plaintiffs' amended return was inaccurate only because it used as the basis for computing capital gain or loss the greater of the plaintiffs' original cost of the assets sold or exchanged or the fair market value thereof as of July 1, 1969.

Section 12-505 of the 1969 act contained definitions.[1] Section 12-506(a) contained the language imposing the tax,[2] and § 12-518 authorized the tax commissioner to adopt and enforce rules and regulations relating to the administration and enforcement of the tax.[3] Eight questions were reserved for the advice of this court. In their brief the plaintiffs have indicated that two of these need not be answered. The remaining six questions are printed.[4]

1. "[General Statutes] Sec. 12-506. DEFINITIONS. When used in this chapter, unless the context otherwise requires: 'Taxpayer' means each and every individual resident in this state who has earnings received, credited or accrued in any taxable year from gains from the sale or exchange of capital assets which exceed the sum of one hundred dollars; 'taxable year' means the same accounting period as the taxpayer's taxable year for federal income tax purposes or that portion of such year as falls within the period July 1, 1969, through June 30, 1971; 'tax commissioner' or 'commissioner' means the state tax commissioner; 'gains from the sale or exchange of capital assets' means 'net gain' as that amount is computed under the internal revenue code of the United States, except that no reduction shall be allowed for loss carry-overs or loss carry-backs."

2. "[General Statutes] Sec. 12-506. IMPOSITION OF TAX. (a) A tax is hereby imposed at the rate of six per cent on all gains from the sale or exchange of capital assets occurring after July 1, 1969, which gains have been earned, received, accrued or credited to the taxpayer during his taxable year. This tax shall not be applicable to gains on the sales or exchanges of capital assets occurring after June 30, 1971."

3. "[General Statutes] Sec. 12-518. ENFORCEMENT, REGULATIONS. The commissioner shall enforce the provisions of this chapter and may adopt and enforce rules and regulations relating to the administration and enforcement of this chapter. The commissioner may prescribe the extent to which any ruling or regulation shall be applied with retroactive effect."

4. "1. In computing the plaintiffs' capital gain on the difference between the amount realized from the sale or exchange of said capital assets and the adjusted basis, i.e. the cost, of such assets, has the defendant Tax Commissioner properly determined the capital gain to be subject to tax pursuant to the Act?

"2. In denying the plaintiffs' claim for refund has the defendant Tax Commissioner improperly determined the capital gain to be subject to tax pursuant to the Act?

"3. If the answer to (1) is 'Yes,' or the answer to (2) is 'No,' does the tax imposed upon the plaintiffs' capital gains under the

Basically, it is the contention of the plaintiffs that the tax commissioner incorrectly interpreted the 1969 act when he denied their claim for a refund, or, alternatively, that if his interpretation of that act was correct, then the act itself is unconstitutional.

Although the language of the 1969 act differs somewhat from that of the 1971 act, the same basic questions of statutory interpretation and constitutionality which we discussed at length in the *Kellems* case are presented by this appeal. Consequently it is neither necessary to repeat in detail much of what we said in the opinion in that case, nor productive to quote extensively from the authorities therein cited and relied on.

The definition of "gains from the sale or exchange of capital assets" in the 1969 act differs slightly from that used in the 1971 act. The 1969 act (§ 12-505) defines it "as that amount is computed under the internal revenue code of the United States, except that no reduction shall be allowed for loss carry-overs or loss carry-backs." The definition in the 1971 act (§ 12-505), which is somewhat longer but similarly keyed to the Internal Revenue Code, states that it means "net gains as defined for federal income tax purposes, after due allowance for losses and holding per-

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Act violate the provisions of Section 55-3 of the General Statutes of Connecticut, Revision to 1958, as amended?

"4. Does the tax imposed upon capital gains under the Act deprive the plaintiffs of their property without due process of law as guaranteed by Section 1 of the Fourteenth Amendment to Constitution of the United States of America and by Article 1, Section 8 of the Constitution of the State of Connecticut?

"5. Does the tax imposed upon capital gains under the Act deprive the plaintiffs of the equal protection of the laws so as to violate Art. I, Section 20 of the Constitution of the State of Connecticut or the Fourteenth Amendment of the Constitution of the United States of America?

• • • • •

"7. With respect to the plaintiffs, has there been an unlawful delegation of legislative power created in the Act due to the defining of certain terms with reference to the Internal Revenue Code of the United States?

iods, but not nonrecognition of gains, all as provided under federal income tax law." As we noted in the *Kellems* case, the federal capital gains tax which both the 1969 and 1971 acts incorporate is predicated on the concept of taxing the realization of capital gain. "Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one." *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 249, 52 S. Ct. 538, 76 L. Ed. 1083; see also the cases cited on this point in the *Kellems* case. As we pointed out in the *Kellems* case, it is the event of realization of gain by the sale or exchange of a capital asset which is the time fixed for the imposition of the tax. The fact that the gain may be the result of a gradual increase in the value of the asset over a period of years is of no consequence. By the 1969 act the tax is imposed on such gains "occurring after July 1, 1969." § 12-506. By the 1971 act it is on such gains "occurring after December 31, 1970." § 12-506. As both acts specifically incorporate the federal system of taxing capital gain, the defendant tax commissioner was correct in holding that the cost basis for determining the amount of the plaintiffs' capital gain should be determined under the provisions of the federal Internal Revenue Code which is, generally, cost.[5]

We deem it unnecessary to discuss at length the remaining contentions of the plaintiffs since they are substantially similar to those advanced and decided in the *Kellems* case. As we there indicated, a tax on the realization of capital gains does not operate a constitutionally impermissible and

5. Under the provisions of § 1053 of the Internal Revenue Code, if the asset was purchased by the taxpayer prior to March 1, 1913, then his basis, subject to adjustment, is the fair market value of the asset on March 1, 1913. In addition, there are numerous other sections of the Internal Revenue Code which define, adjust or allocate a taxpayer's basis depending on the circumstances surrounding a transaction. See, for example, Internal Revenue Code §§ 301(d), 301(f), 307, 1336, and others.

retroactive manner merely because the amount of the taxable gain is determined by the difference between the proceeds from the sale or exchange and the basis to the taxpayer which, as we have indicated, is usually his cost but may be the fair market value on March 1, 1913, if the asset was owned by him prior to that date. Nor, for the reasons discussed in the *Kellems* case, do we find that the 1969 act unlawfully delegated powers to the tax commissioner or to the Congress of the United States. We note that as in the 1971 act the 1969 act did not expressly provide whether the reference to the Internal Revenue Code of the United States was intended to refer only to the code as it existed at the time of the passage of the 1969 act or was intended to include any amendments to the code which Congress might subsequently enact. It does appear that subsequent to the enactment of the 1969 act Congress did, by §§ 511 to 516 of the Tax Reform Act of 1969 (83 Stat. 635-647), amend the federal tax laws with respect to the taxation of capital gains. These amendments, however, were effective only with respect to taxable years beginning after December 31, 1969, and, as the stipulation of the parties in this case discloses, the transactions which resulted in the realization of capital gains by the plaintiffs all occurred in the 1969 tax year between July 1 and December 31, 1969—all before the effective date of any amendments to the federal income tax law as it existed when the 1969 act was adopted. So far as these plaintiffs and this case are concerned, it is unnecessary to determine the effect of any amendments to the Internal Revenue Code which were made effective subsequent to December 31, 1969.

The Superior Court is advised that question 1 in the reservation is answered "Yes" and question 2, 3, 4, 5 and 7 are answered "No."

No costs will be taxed in this court in favor of any party.

In this opinion the other judges concurred.

COPY

SEP 21
MICHAEL RODAK, JR.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972.

No. 72-283

GEORGE E. MAHIN, AS DIRECTOR OF REVENUE OF THE STATE OF ILLINOIS,

Petitioner,

vs.

TERRANCE R. MITCHELL, ASALEE LABORN, ERNEST J. NASSOS, JOHN A. PETERSON AND FREDERICK W. WENDNAGEL,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

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OPINIONS BELOW.

The order of the Circuit Court of Cook County, Illinois, Law Division, was entered on January 19, 1971, and the opinion of that Court was filed on February 4, 1971. The order and opinion are not reported, but are printed in their entirety in the Appendix to the Petition. The opinion of the Illinois Supreme Court is reported in 51 Ill. 2d 452, 283 N. E. 2d 465, and is also printed in the Petition.

JURISDICTION.

The claimed jurisdictional requisites are adequately set forth in the Petition. The respondents do not believe that the Court has jurisdiction under 28 U. S. C. § 1257(3).

QUESTION PRESENTED.

Does this Court have jurisdiction to review a state court's construction of a state act

(a) Where the state court expressly denied that its construction was compelled by an interpretation of the United States Constitution;

(b) Where the review of the state court's decision would not be preliminary to the consideration of a substantial federal question?

STATEMENT OF THE CASE.

Since we believe that petitioner's statement of the case does not adequately set forth the facts necessary to understand the issues, we undertake to restate some of the facts.

In *Thorpe* v. *Mahin*, 43 Ill. 2d 36, 250 N. E. 2d 633 (1969), the Illinois Supreme Court held the Illinois Income Tax Act to be constitutional and in so doing construed the Act, stating at 49-50:

> "It is next urged that the stated subject of the Act is income and the Act either fails to express its subject at all or embraces more than one subject in violation of section 13 of article IV of the constitution, and further provides for taxation of property without including that subject in the title of the Act. This is predicated upon the holding in *Bachrach* that an income tax is a property tax within the meaning of section 1 of article IX. In the view we have taken of the *Bachrach* case this point has no validity. But, it is further suggested that even if *Bachrach* is overruled, a problem remains in section 13 of article IV because unrealized capital appreciation accruing prior to the effective date of the Act is property, not income. This poses no problem as will presently appear.
>
> "Petitioners argue that if the Act is to be applied to the realization of increased value of capital assets accruing prior to August 1, 1969, they would thereby be deprived of property without due process of law and be denied equal protection of the law. For the reasons hereafter given, we consider the legislative intent to be that, in the computation of capital gains and losses, the value of property acquired prior to August 1, 1969, shall, for the purpose of computation of gains or losses be limited by its value determined as of August 1, 1969."

When the Illinois Department of Revenue subsequently issued instructions and regulations limiting the August 1, 1969 valuation date to property described in Section 1221 of

the Internal Revenue Code of 1954, the present suit was brought to challenge the Department's interpretation of the Act. That interpretation limited the application of the August 1, 1969 valuation date. In addition it raised for the first time the question of whether income earned and received by respondents Mitchell, Laborn and Nassos prior to August 1, 1969 was subject to a tax imposed solely upon the privilege of earning and receiving income after July 31, 1969. (Section 201, Illinois Income Tax Act.)

On appeal from a trial court decision holding in favor of the plaintiffs, the Director of Revenue of the State of Illinois, petitioner herein, urged the Illinois Supreme Court to overrule *Thorpe* and to hold that the Act should be construed so as not to apply an August 1, 1969 valuation date to any assets, and to impose a tax on income earned and received before August 1, 1969 if reportable for federal tax purposes after July 31, 1969.

Affirming the trial court and adhering to its determination of legislative intent in *Thorpe*, the Illinois Supreme Court stated, *Mitchell* v. *Mahin*, 51 Ill. 2d 452, 283 N. E. 2d 465 (1972):

> "The defendant's argument obviously presumes that in *Thorpe* we felt compelled to find a legislative intent to establish an August 1, 1969, valuation limitation in order to avoid constitutional problems which might stem from making the income tax applicable to appreciations in value occurring before August 1, 1969. *Thorpe* was decided without reaching the question of whether retroactive application rendered the Act unconstitutional, and the language to which defendant refers is clearly a discussion of the divergent and conflicting decisions on the subject and not a holding of this court with respect to the issue." 51 Ill. 2d 45 at 455-456.

Likewise, the Illinois Supreme Court in this case did no decide whether retroactive application would render th Act unconstitutional.

ARGUMENT.

I.

THE DOCTRINE THAT THIS COURT CANNOT BE DEPRIVED OF JURISDICTION TO DECIDE A SUBSTANTIAL FEDERAL QUESTION BY A STATE COURT'S RESTING ITS DECISION SOLELY ON AN UNSUPPORTED STATE GROUND HAS NO APPLICATION TO THIS CASE.

Petitioner argues that the Illinois Supreme Court's determination of the intent of the Illinois Legislature was without support. He then relies upon the doctrine that this Court cannot be deprived of jurisdiction to decide a substantial federal question by a state court's resting its decision solely on an unsupported state ground.

We do not, of course, challenge the validity of that doctrine. A state court cannot, for example, prevent an appeal being carried to this Court to review a substantial question of due process by resting its decision solely on an unsupported state procedural ground, *N.A.A.C.P.* v. *Alabama*, 357 U. S. 449 (1958).

An examination of the briefs submitted to the Illinois Supreme Court in *Thorpe* and in this case, and of the decisions in both cases, would reveal that there was, indeed, substantial support for its determination of legislative intent. Nonetheless, without regard to that, and without regard to the fact that the doctrine has never been applied to a state court decision, like that of the Illinois Supreme Court here, as to substantive, rather than procedural, state law, the doctrine on which petitioner relies has no application here.

Under the doctrine, the unsupported state ground is brushed aside to permit the petitioner to submit to this

Court for consideration a substantial federal question which was not, but should have been, decided by the state court.

Here, while the petitioner argues the federal constitutional question which the Illinois Supreme Court did not decide—whether or not the taxation of pre-August 1, 1969 gains would violate due process requirements—he does not ask this Court to decide that question, other than in the context of an alleged constitutional compulsion, which is discussed in the next section of this brief, or argue that the resolution of the question was evaded in order to deprive this Court of jurisdiction.

Since the Illinois Supreme Court held the Illinois Income Tax Act constitutional, there would be no need to resolve the undecided due process question unless petitioner challenged the constitutionality of the Act as construed. Plainly, that he does not do. There is, therefore, no dispute between the parties as to the constitutionality of the Act as construed by the Illinois Supreme Court.

What petitioner seeks in this Court, in reliance on cases which state the principle that this Court's jurisdiction to decide substantial federal questions may not be defeated by a state court putting forward nonfederal grounds of decision which are without fair or substantial support, is a decision that the Illinois Supreme Court's construction of the Illinois Income Tax Act was wrong, not as a preliminary to considering a substantial federal question, but as an end in itself. Certainly this Court has no jurisdiction to render such a decision. *Chicago, Rock Island & Pacific Ry.* v. *Maucher*, 248 U. S. 359 (1919); *Palmer* v. *State of Ohio*, 248 U. S. 32 (1918); *Memphis Natural Gas Co.* v. *Beeler*, 315 U. S. 649 (1942).

II.

THE STATE COURT DECISION WAS NOT COMPELLED BY AN ERRONEOUS VIEW OF THE FEDERAL CONSTITUTION.

Where a state court decision on state grounds is compelled by the court's interpretation of the United States Constitution, and where there is substantial reason to believe that the interpretation may have been incorrect, this Court, as petitioner urges, has entertained jurisdiction to consider the underlying federal question. *State Tax Commission* v. *Van Cott,* 306 U. S. 511 (1939); *Minnesota* v. *National Tea Co.,* 309 U. S. 551 (1940); *Perkins* v. *Benguet Consolidated Mining Co.,* 342 U. S. 437 (1952).

This Court has, however, never undertaken to review a state court decision on state grounds when the state court did not decide the potential federal question and expressly stated that its decision on state grounds was not compelled by any view as to the federal question. It should not do so here.

III.

THIS COURT HAS NO JURISDICTION TO RESOLVE A CONFLICT BETWEEN STATE COURTS ON MATTERS OF STATE LAW.

Petitioner argues that other states have construed similar state income tax acts differently.

Needless to say, that difference as to state law does not confer jurisdiction on this Court to enter the controversy, however desirable uniformity among state laws may be.

There is no conflict between the Illinois Supreme Court and other states on the question whether the retroactive application of an income tax act violates due process re-

quirements, because, as recognized by the Connecticut Supreme Court in *Kellems* v. *Brown, Tax Commissioner* (Supp. Br., A1), the Illinois court did not decide that question.

CONCLUSION.

We respectfully submit that the petition for certiorari should be denied.

Respectfully submitted,

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